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The Economic Paradox of Austerity after the 2008 Crisis

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Introduction

The objective of this analysis consists of investigating further the apparently never-ending crisis that has been affecting the European Union, ten years after the bursting of the housing bubble in the United States.

Through this study, it will be possible to understand the dynamics that led to the crisis, the causes for its development, and the reason why it is so hard to restore a significant economic development and to fight unemployment and lack of confidence.

The essay starts with a resume of the main causes of the United States Subprime Mortgage Crisis, and what it meant for American economy and finance.

Later, it will be analysed in what way the crisis reached the Old Continent, and developed. This chapter is divided in several segments. The first sub-chapter studies the country most affected by the crisis – Greece. Later we observe how a housing bubble created a crisis in Ireland and Spain. The last sub-chapter analyses two countries with common features, Italy and Portugal. The most important events will be summarised.

Taking into consideration the responses to the crisis, we pass then to examine austerity and liberalism using a critical theoretical and historical approach. Even the current financial and economic situation will be studied, trying to prove how austerity and the liberal ideology behind have contributed to the crisis, and have created a larger gap between the upper class and the middle-lower class,

In the following chapter, we will try to demonstrate that alternatives to austerity exists and that they have ever existed, it will be used a Keynesian approach, using contributions from post-Keynesians and neo-Keynesians.

Finally, the current Italian financial and economic situation will be studied. The most important events will be cited, and we try to explain the reason why it is so hard to departure from that mainstream financial regime, as the government is experimenting, and what we can expect from the budget law for 2019.

In the conclusion, the most important results from the study will be taken into consideration

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The Fuse: An American Crisis

The origin of the European Debt Crisis is not located in the Old Continent. As we will see, there are elements of the European System that enabled the bomb to set off, but it was on the other side of the ocean that the fuse lighted. The fuse is the United States Subprime Mortgage Crisis, which was a nationwide financial crisis, taking place between 2007 and 2010. It was provoked by a massive decline in home prices following the bursting of a housing bubble, leading to mortgage foreclosures and delinquencies and the devaluation of housing-related securities. Through contagion the crisis reached several parts of the finance and of the economy, and consequently tha market froze. Banks and other financial institutions failed or received a bail-out, through which the problems of the banks became the problems of the taxpayers. The housing bubble that anticipated the crisis was financed with Collateralized Debt Obligations (CDOs) and Mortgage-Backed Securities (MBSs), which at first granted higher interest rates rather than government securities, along with attractive ratings from the Big Three credit rating agencies. (Blyth, 2013) CDOs and MBSs are linked to the concept of securitization – the packaging of bank loans to generate tradeable bonds. Securitization started in the 1970s, when Government Sponsored Enterprises started to collect relatively safe "prime" mortgages, creating Mortgage-Backed Securities and selling them to investors. The advantage of securitization, as seen by Alesina (2009), was that it removed the loans from banks' books, enabling them to remain in conformity with capital requirement laws. But the big disadvantage was that it developed a moral hazard, since the institution or bank creating loans no longer had to worry whether the mortgage was paid off, giving them incentive to execute mortgage transactions while not ensuring their credit quality (Lewis, 2010). This process of securitization was about "slicing" the pooled mortgages into "tranches", each

having a particular priority in the interest and principal stream. As it was explained by Reinhart (2009), tranches can be compared to buckets collecting the water of interest and principal. Most senior buckets do not share water with those below as far as they are filled to the brim and overflowing. This gave the top tranches considerable creditworthiness resulted in AAA credit ratings, making them saleable to pension funds and money markets that would not alternatively deal with subprime mortgage securities because they were considered too dangerous. Then, in order to be able to sell even Mortgage Backed Securities tranches lower in payback priority, that a conservative fixed income market would not be willing to buy, investment banks invented another security – the Collateralized Debt Obligation. These CDOs pooled the remaining A-, BBB etc. rated tranches, and produced new tranches, 75% to 80% of which were rated AAA. This process was later criticised as "ratings laundering" since junk tranches were disguised as trustworthy securities (Blyth, 2013).

This crisis shows that not all crises originate in developing countries. Indeed, the work of Reinhart and Rogoff (2009) observes that, historically, the developed world is as likely as the developing world to experience financial crises. As noted by Blyth (2013, 24), “The crisis is over-explained in that there are so many possible suspects who can be rounded up and accused of being the cause that authors can construct convincing narratives featuring almost any culprit. “ One thing is however for sure, this is a private-sector crisis. The causes of this crisis were located in the U.S. economy and included securitization (as seen above), an unprecedented housing price bubble, huge inflows of capital (financing a current account deficit of more than 6 per cent of GDP), inaccurate credit ratings, a lack of prudential financial regulation, and the damage done by a set of economic ideas.

With regard to the housing market in the United States, there developed an extremely risky subprime mortgage market that included mortgages known by the acronyms NINA (no

income, no asset) and NINJA (no income, no job or asset). The only thing an applicant had to show was their credit rating, which was supposed to reflect ability and willingness to pay. This was not a problem for the banks because with the new financial instruments seen above the risks were transferred to investors. The percentage of lower-quality subprime mortgages created during a year rose from the usual 8% or lower range to approximately 20% in 2006. High portions of these mortgages, over 90% in 2006 for example, were Adjustable-Rate Mortgages (Inside Mortgage Finance).

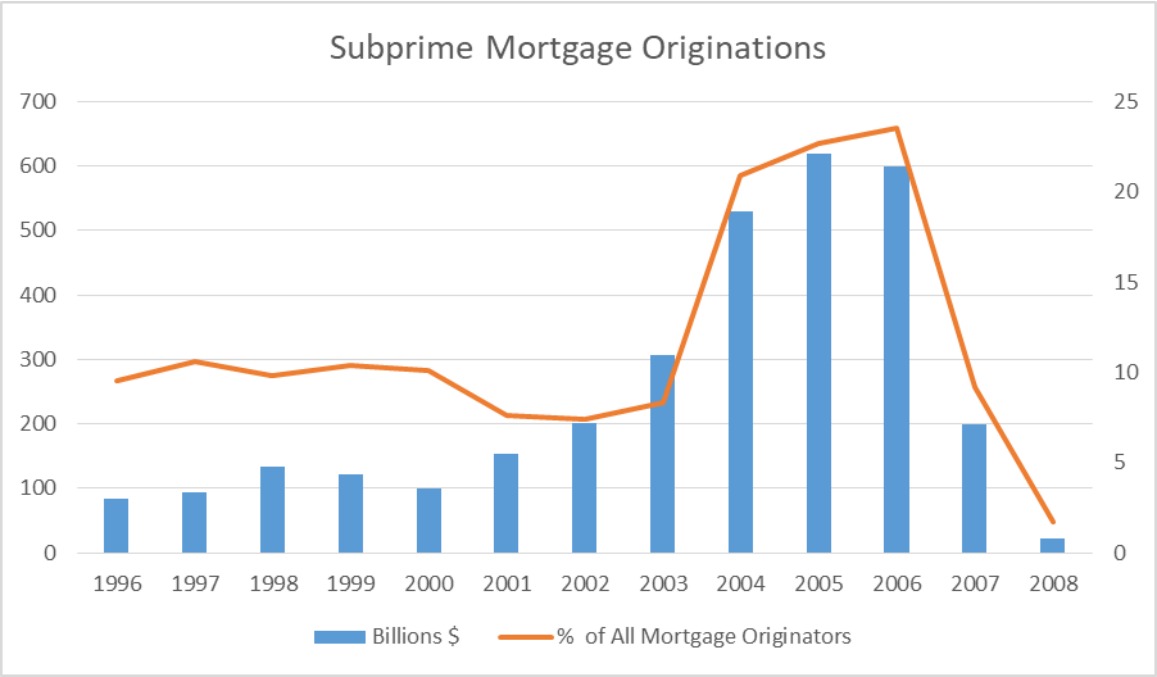

Fig.1 *US Subprime Mortgage Originations from 1996 to 2008*, source: Inside Mortgage Finance

Another indicator of a "classic" boom-bust credit cycle was a closing in the difference between subprime and prime mortgage interest rates (the subprime mark-up) between 2001 and 2007. In other words, the interest rate that had to be paid for a subprime mortgage or for a prime mortgage was almost the same. Along with the presence of these considering higher-risk borrowers, lenders were offering progressively riskier loan options and borrowing

incentives. In 2005, the median down payment[1] for first-time homebuyers was 2%, with approximately 45% of those buyers making no down payment at all. Comparatively, China had down payment requirements that surpassed 20%. Even second loans became extremely popular. These loans were called "silent" because the primary lender was not supposed to know about their existence.

Housing speculation also increased, with the share of investors (those owning homes other than primary residences) growing dramatically from around 20% in 2000 to 35% in 2007. (FRED economic data) The existence of pure speculation in the market was highlighted by Vogel (2009, 43-44). He noticed that, “it was not unusual to see crowds and bidding frenzies whenever blocks of new housing units were opened for public sale. Many of these most aggressive buyers never intended to actually reside in the units; they were leveraged speculators taking advantage of easy credit and regulatory conditions and buying only with the intention of quickly flipping them to someone else at a higher price.” According to Robert Shiller and other economists, housing price increases above the general inflation rate cannot be sustained in the long run. Between 1997 and the peak of the bubble in 2006, the price of the conventional American house rose by 124%. The Oracle of Omaha, Warren Buffett, testified to the Financial Crisis Inquiry Commission that: "there was the greatest bubble I've ever seen in my life...The entire American public eventually was caught up in a belief that housing prices could not fall dramatically." But even the most successful investor in history was wrong when he talked about the crisis. In April 2008, he declared, “The worst of the crisis is now behind us.” Five months later Lehman Brothers failed.

[1] Down payment is a payment adopted in the situation of the purchase of expensive goods such as a house and a car, where this payment is the initial upfront portion of the total amount due and it is frequently paid in cash or with a check at the time of concluding the transaction.

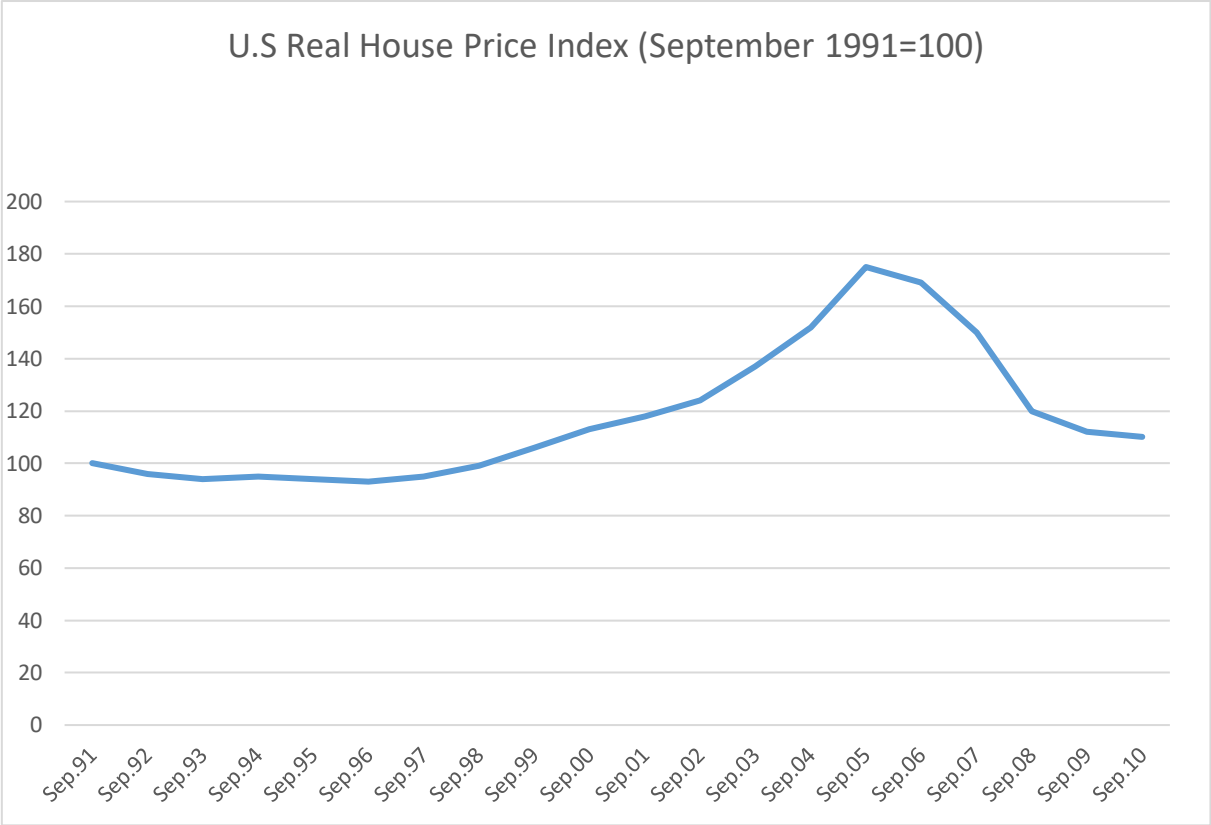

Fig.2 *U.S. Housing Bubble (House Price Index)*, source: FRED Economic Data

The real problem was that although housing prices were skyrocketing, people were not making any more money. The bubble resulted from householders refinancing their houses at lower interest rates, or financing consumer spending by subscribing second mortgages secured by the price appreciation. This means that consumption was fostered by people who were ever more indebted and that thought that the price of their houses would continue to increase indefinitely. To make matters worse, easy credit, and the assumption that home prices would continue to rise, encouraged subprime borrowers to obtain Adjustable-Rate Mortgages[2]. These mortgages attracted borrowers with a below market interest rate for some prearranged period, which would have increased in the future. But this was not seen as a problem, since they thought that they could earn more money and since borrowers who were

[2] An adjustable-rate mortgage (ARM) is a mortgage loan with the interest rate on the note regularly adjusted based on an indicator that reflects the lender's cost of borrowing on the credit market.

not able to make the higher payments once the initial grace period ended, could refinance their mortgages after a year or two of appreciation receiving the money to pay the higher interest rates. Even the banks did not see the problem, they considered to be out of danger thanks to securization or moral hazard, but some of them would have soon discovered that it was not the case (Krugman, 2009). As noted by Keynes in an article for the Economist (1947), "If you owe your bank manager a thousand pounds, it is your problem, but if you owe him a million pounds, it is their problem."

This credit and house price burst led to a building boom and finally to a surplus of unsold homes, which caused housing prices begin declining in the second part of 2006. Because of these depreciating housing prices, borrowers' ability to refinance became more limited. Borrowers who were unable to support higher monthly payments started to default. As more borrowers defaulted, the supply of homes for sale increased. This placed further downward pressure on housing prices, which further lowered householders' equity. This major decline in house prices meant that many borrowers had zero if not negative equity in their homes, in other words their homes were worth less than their mortgages. By October 2010, 25% of all U.S. homes were worth less than the mortgage loan. These mortgages were typically nonrecourse debts secured against the property. That debt is secured by a guarantee given by a collateral, which is usually real property, but for which the borrower is not personally liable. In other words, in the event that the borrower defaults, the lender can take and sell that collateral, but if it is sold for less than the debt, it is the lender's problem, who cannot ask the borrower to balance the deficiency. This is because their recovery is limited to the value at which the collateral was sold. Blyth (2013) pointed out that given this nature of mortgages, borrowers had an incentive to default, causing prices to lower again further.

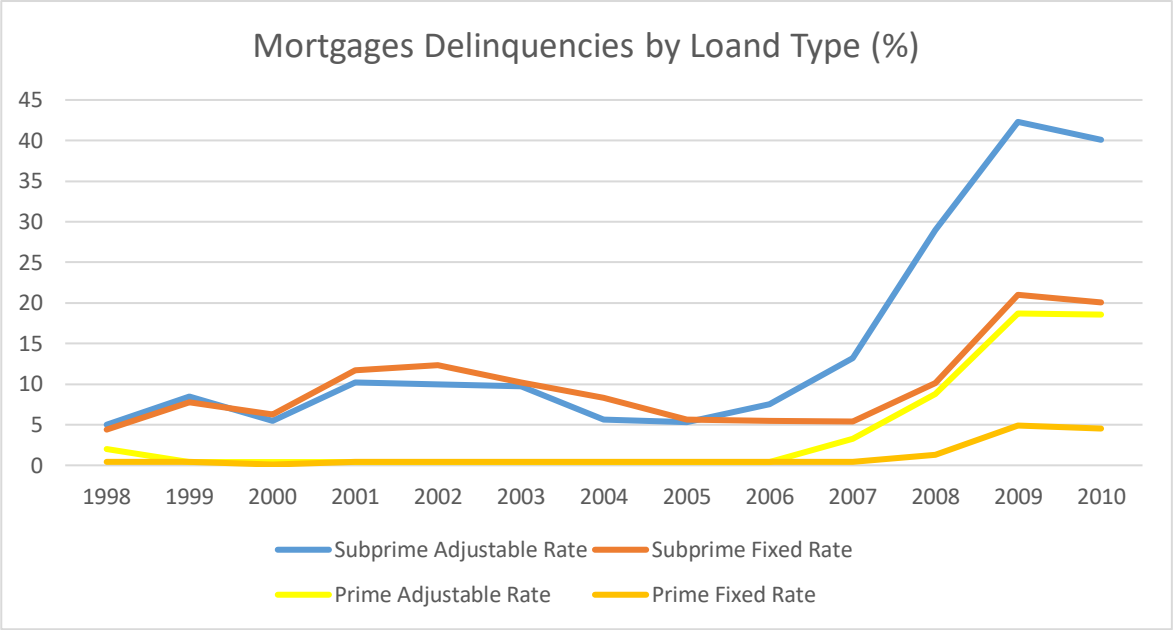

Fig.3 *Mortgages Delinquencies (90 days or more past due and those in foreclosure)*, source: Mortgage Bankers Association National Delinquency Survey (Financial Crisis Inquiry Report)

Various factors helped to set the stage for the rise and fall of housing prices, and related securities. In the years leading up to the crisis, as noted by the Financial Crisis Inquiry Report, the United States received large amounts of foreign money from oil-producing countries and fast-growing Asian economies. This inflow of funds combined with low interest rates contributed to easy credit conditions, which fuelled both credit and housing bubbles. Loans of several types could be obtained easily and consumers assumed an unprecedented debt load. As part of the credit and housing booms, the number of assets called Mortgage-Backed Securities, which determine their value from house prices and mortgage payments, considerably increased. Krugman (2009) noted that this financial instrument enabled global investors to invest in the United States housing market. However, as prices declined, major global financial institutions that had invested heavily in Mortgage Backed Securities reported serious losses. Global investor demand for MBS disappeared. While the crisis spread from the real estate market to other segments of the economy, even other types of loans experienced

significant losses and defaults. To make matters worse, the problem was made bigger by Credit Default Swaps. CDS are financial derivates supposed to be used as a hedge and protection for investors, in particular MBS investors (in this case, the instrument is called even synthetic CDO), from the possibility of default, but which were commonly used by speculators in order to profit from that default. Economist Joseph Stiglitz observed how a systemic disaster was created with the use of CDS, since with a huge amount of bets even on the same security, it was impossible to be sure of the financial situation of anyone or also of their own position. Unsurprisingly, this caused the credit markets to freeze. Writer Michael Lewis pointed out that it was comparable to allowing many people to purchase insurance on the same home. Speculators who purchased credit default swaps were wagering that important defaults would have occurred, whereas the sellers (insurance companies) were betting that they would not. In theory, a limitless amount could be bet on the same securities, as far as sellers and buyers of the CDS were found. To put it another way, a credit default swap is fundamentally an insurance policy. The purchaser of the instrument is insured against the default of the security upon which the CDS is written. In exchange, the writer of the insurance policy, the issuer of the swap, obtain a regular revenue stream from the purchaser, similar to insurance premiums given to insurance companies. The main dissimilarity is that insurance companies calculate the risks they are taking with the use of instruments as actuarial tables, then analysing how much cash is needed to cover those risks. On the contrary, as noted by Blyth (2013), the writers of the CDSs did not keep much capital in reserve to cover losses because the probability of default of a given entity (Lehman Brothers, for example) is considered to be extremely unlikely, and if you write a CDS contract on that entity, you will not think that you have to keep very much capital at all in reserve to cover anticipated losses because no such losses are considered possible.

The third cause of the crisis were inaccurate credit ratings. Credit Rating Agencies have come under close examination after the crisis for having given creditworthy ratings to credit default swaps and mortgage-backed securities based on highly risky subprime loans that soon after defaulted. For this reason, the Big Three rating agencies (Fitch Ratings, Moody's Investors Service and Standard & Poor's) received hundreds of lawsuits by investors. Financial expert Joseph Stiglitz characterized them as "one of the key culprits" of the crisis. What happened was that the majority of investors had a lack of knowledge about the mortgage business, and even less experience with the complexity of pools of mortgages and tranche priority of the new financial instruments. They simply needed an independent party able to rate securities. However, the supposed independent parties meanwhile were receiving attractive funds by banks in order to obtain the desired ratings. Banks were looking around for the best ratings, frequently menacing to cease business after a rating not enough generous. It is obvious that there was a conflict of interest between meeting the wants of banks and correctly rating for the benefit of the investors, who unlike banks guaranteed zero income. Between October 2007 and May 2008, agencies downgraded approximately $2 trillion Mortgage-Backed Securities. At the end of 2008, three out of four collateral debt obligations rated "triple-A" were downgraded to junk. In a sadly ironic way, the Big Three's market share of ratings has almost not declined, moving from 98% to 97%. What is more, the ratings of these agencies are still an unchallengeable opinion about the trustworthiness of government securities, being able, as we will see, to sink one country's finance.

As noted above, another cause of the crisis can be found in the lack of financial regulations. Specifically, as pointed out by Blyth (2013), policy-makers did not recognize the growingly

big role played by the shadow banking system[3], composed by hedge funds[4] and investment banks and which includes the repo market. In the repo market, borrowing and lending have a very short deadline and low interest rates, usually trading assets for cash and then repurchasing those assets the very next day, thus sale and repurchase, or "repo." What happened in the midst of the crisis was that hedge funds and investment banks imploded, having strongly invested in MBSs and CDOs that had lost nearly all their value, and, consequently, a bank run through the repo market. A bank run happens when the majority of the depositors want their cash back at the same time, but the bank does not have enough money.

The last cause of this crisis are a set of economic ideas that developed from the 1970s on, called neoclassical or neoliberal ideas. Before 1970s, Keynesianism[5] had been dominating the economic thinking. However, the opposition spread, and the economy of the mid 1970s was trading in inflation with unemployment in a new phenomenon called "stagflation," where inflation and unemployment could coexist and rise together. This undermined the credibility of Keynesianism, since in its theory it was not possible the coexistence of inflation and unemployment. It was a great chance for then-marginalized economists who did not agree with the distributional implication and the focus on aggregates rather than individuals of the Keynesian instruction sheet to write a new one. This new instruction sheet was called neoliberalism. The starting point was the assumption that individuals are super smart processors of information. The new ideology mistrusted anything other than the individual,

[3] The shadow banking system consists of non-bank financial intermediaries that supply services analogous to conventional commercial banks but external to normal banking regulations.

[4] Hedge funds are alternative investments that use pooled funds utilized in several different strategies to earn active return for the investors.

[5] John Maynard Keynes (1883-1946) was a British economist whose thoughts radically changed the theory and practice of macroeconomics. His theories are the basis for the school of thought known as Keynesian economics, and its various developments.

and had two main assumptions: individuals are selfish agents who try to maximize their interests, and free markets guarantee the highest well-being. Consequently, while neoliberals expect mistakes made by random individuals in the market, they do not consider possible systematic mistakes of the market, since it is considered the reflection of individual optimal choices that together produce the right price. By thinking that markets are perfect bodies, the notion of regulating finance becomes nonsense. From this viewpoint, risk is tradable, calculable and investors are rational actors who know what they are buying. Financial-expert Nouriel Roubini (2009) understood that it was ignored the possibility of a crisis arising from an imperfection of the market, since only state-induced political shock could have been the cause. As noted by economist Luigi Spaventa (2008), "The crisis should represent a lesson to all economists. It should teach them to refrain from falling in love with sophisticated theories that do not fit with the reality of the world where we live in." The claim that the prices at which financial assets traded represented the right price was, when the bubble burst, dramatically contradicted. Italian economist Alessandro Roncaglia observed that (2010, 7), "The mistakes of the dominant economic model led us to dance blindfolded on the ropes of the crisis, and then falling in. The myth of the omnipotent invisible hand of the free market, blind faith in the automatic mechanisms, hostility toward the setting of rules, and the systematic under-estimation of uncertainty were serious errors," and then (2010, 81), "It is not true that economists did not foresee the crisis. Those who did not foresee it are the mainstream economists, Washington Consensus' supporters. The concerns of heterodox economists who foresaw the crisis were not published in the paper, often controlled by major financial groups, or in the main academic publications, controlled by a closed circle of mutual enhancement of mainstream representatives." In fact, someone did foresee the crisis. On 7 September 2006, in a meeting of the International Monetary Fund, the American economist

Nouriel Roubini gave a speech in which he argued that a financial catastrophe was imminent in the US and Europe. He said that, “in the next months, the US will face a property bubble without precedent in the history”. A property bubble that “will lead to a deep recession”. And again, “there will be mortgages defaults, trillion dollars will vanish and the global financial system will arrest”. He was not heard. After his speech scepticism reigned, pointed out by the following intervention of the economist Anirvan Banerji, who criticised Roubini because he had not used mathematical models to explain his theories, and by other economists who nicknamed Roubini as “Mr. Doom”. Nonetheless, Roubini continued with his thesis, foreseeing even a systemic risk in an article called “The US Crisis Can Infect the World”, published on 10 September 2007. He wrote, “In a globalised world, shocks at the centre of the system have painful effects on the rest of the world, the financial markets and the real economies”. Roubini is only an example of several economists who were afraid of the situation of the United States. It would have been even enough to listen to the Master of Economic, John Maynard Keynes. He considered the market as a runaway horse to be tamed. He famously said that (1933), “Capitalism is not intelligent, it is not beautiful, it is not just, it is not virtuous, and it does not deliver the goods”. He even noticed that the availability of large sums of money is the main cause of financial speculation. Speculation was derived by the finanziarization and liberalization of the economy, consequently he argued that financial transactions should have been taxed. Furthermore, he argued that risk can be quantified but uncertainty cannot, which made all the algorithms and the mathematics that wanted to measure the riskiness of complex financial instruments completely useless in a market characterized by panic, or even harmful.

But the world of the finance was dominated by neoliberalism, and by economists who mythicized what it had produced. In 2003, economist Luigi Zingales wrote, “Derivates allow

to spread risks in a more accurate way than other assets. Since the risks are distributed to several individuals, no investor needs to worry." Four years later, the professor of the Bocconi University Francesco Giavazzi agreed with Zingales, and wrote, "With the new system, banks, when do the lending, can sell it immediately to other investors. The risk spreads through several investors. It is intuitive that a market with more participants can absorb fluctuations better than a market with fewer participants." Intuitive but incorrect. Even when the crisis arrived, financial-experts did not want to see it. In 2007, Morgan Stanley's Chief Economist Stephen Roach declared that, "We are in the middle of a soft landing in the housing market that will leave the rest of the economy unhurt". Believing Roach's words, Francesco Giavazzi thought that, "The American sub-prime mortgage crisis rarely will become a generalized financial crisis." In 2008, the columnist of "Il sole 24 Ore" Alberto Alesina wrote that, "This crisis is absolutely not comparable with the 1929 crisis".

Thus, this crisis can be considered as the crisis of the instruction sheet of the past thirty years, but as we will see more in details later, it was not able to destroy its power.

To summarize, as noted by Blyth (2013, 25), there are "four elements that you cannot remove counterfactually and still explain the crisis. They are the structure of collateral deals in US repo markets, the structure of mortgage-backed derivatives and their role in repo transactions, the role played by correlation and tail risk in amplifying these problems, and the damage done by a set of economic ideas that blinded actors—both bankers and regulators—to the risks building up in the system."

The crisis reached a serious point in September 2008 with the bailout, buyout or failure of the largest entities in the shadow banking system. Investment banks Morgan Stanley and Goldman Sachs obtained access to emergency lines of credit from the Federal Reserve. Merrill Lynch was acquired by Bank of America, while Lehman Brothers failed. The Federal

Government gained the control of government-sponsored enterprises Freddie Mac and Fannie Mae. Insurance leader AIG, which had sold credit default swaps for mortgage-backed securities, did not have enough capital to honour its commitments, and taxpayers were compelled to cover its obligations in a bailout that exceeded $100 billion. The risk of interbank lending, calculated via Ted spread quadrupled soon after the Lehman Brothers failure. Credit froze, bringing the global financial system about to collapse. In a dramatic meeting at the end of September 2008, a $700 billion emergency bailout of the banking system was launched by Federal Reserve Chairman Ben Bernanke and Treasury Secretary Henry Paulson. Bernanke famously said, "If we do not do this, we might not have an economy on Monday."[6] On October 3, the Troubled Asset Relief Program became law. The first week of October experienced the largest fall in the history of the Dow Jones, worse than any single week in the Great Depression. According to the data of the US Bureau Economic Analysis, in just one year, unemployment passed from 5% to 10%, residential private investments fell from $800 billion to $400 billion and stock market prices fell 57%.

This study has not the objective to analyse how the crisis was handled in the United States, but it should be noted that recovery was faster and most effective than in Europe. In fact, even if it is a liberal country, the United States were not worried about big deficit to GDP ratio. This is because their currency is the global currency, which gave them advantages, but even because they understood that expansionary policies were the only possible solution to emerge from the crisis. This is even because the Federal Reserve is a real central bank, and not a fake central bank as the ECB has demonstrated to be. The United States could have been used as an example on how to get out of the crisis, but as we will show, the European institutions,

[6] Blodget, Henry. “If we don’do this we won’t have an economy on Monday” Business Insider (2008), data viewed: November 2018 < https://www.businessinsider.com/2008/10/-if-we-don-t-do-this-we-won-t-have-an-economy-on-monday-?IR=T>

trapped in the orthodoxy of austerity decided to follow a different path, which has condemned the European countries to years of recession and unemployment.

As we have anticipated, the interbank system froze and the financial crisis became global. Through systemic risk, the crisis reached Europe. Globalization and free markets created the situation in which each country can be affected by a crisis happening in the other part of the world. As famously claimed by the mathematician Edward Lorenz, “The flap of a butterfly’s wings in Brazil can set off a tornado in Texas.” And this is absolutely true in the economic world where we are living. A bubble in the United States can set off a crisis in Europe. If we desire a free market, we have to accept to be in constant danger, and that global crisis are likely to happen again in the future.

Crisis Impacts Europe

The European Debt Crisis is an ongoing debt crisis that has been affecting the European Union since the last months of 2009. A group of Eurozone member states, known as PIIGS (Portugal, Italy, Ireland, Greece and Spain), was unable to refinance or repay their debt and to bail out or buy out highly-indebted national without the intervention of third parties like the European Central Bank, the International Monetary Fund (IMF), and other European countries.

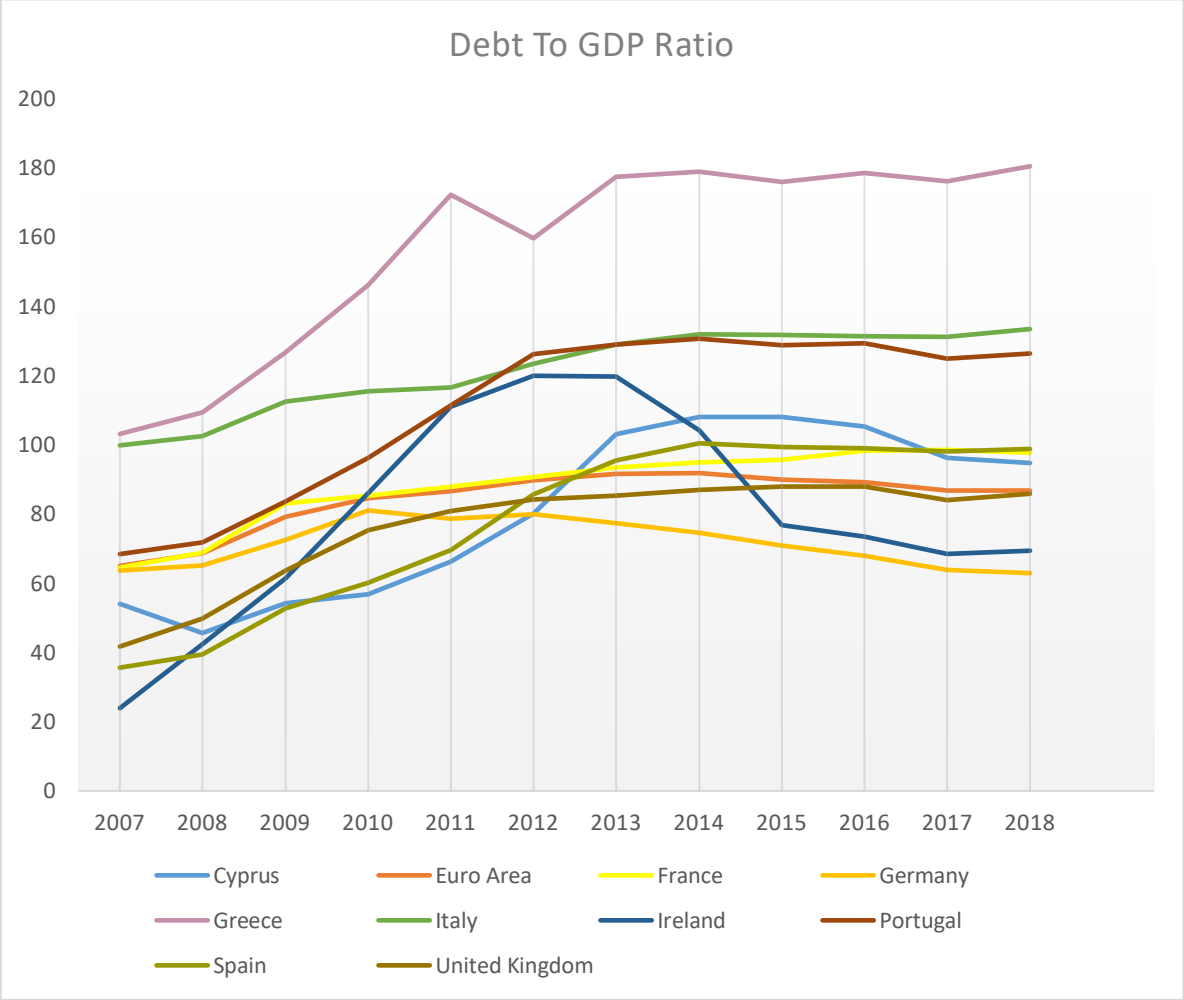

Fig.4 *Debt to Gross Domestic Product Ratio*, source: Organization for Economic Cooperation and Development Stat

As pointed out by Krugman (2012), the causes of the European sovereign debt crisis can be found in structural problems of the Eurozone structure, as well as in a combination of other

factors. These include easy credit conditions encouraging high-risk borrowing and the creation of bubbles since 2002, the global financial crisis and freezing of inter-banking lending system following the US Subprime Mortgage crisis, international trade imbalances, fiscal policy choices related to government expenses and revenues, and the bailing out of troubled banking institutions. The crisis was then made much more dramatic because of austerity[7], which has been used as the recipe to recover, but which has only worsened the situation.

It is usually called a sovereign debt crisis, however this is a quite misleading interpretation of the facts. According to economist Paul Krugman (2012), the narrative in which excessive spending is at the heart of the crisis is not true for anyone except the Greeks. Even Italy had a big public debt, but it was not considered a problem before the crisis since private wealth was twice the debt. For everyone else, the problem was the close interconnection of finance, the deregulated markets created by neoliberalism and the fact that governments had to take responsibility for the banks. The costs of bailing the banks has been between 2.5 and 11.5 trillion euros. Governments absorbed most of the costs of the bust since it ended up in their balance sheets, which is the reason we wrongly call this a debt crisis when in reality it is a well-camouflaged banking crisis.

So as to understand the crisis we need to look at when the Union was created. In 1992, it was signed the Maastricht Treaty, under which the members of the European Union committed to limit their debt levels and deficit spending. Nevertheless, several EU member states, including Italy and Greece, circumvented these rules, eluding best practice and disregarding common agreed standards. Governments were able to camouflage their debt and deficit levels thanks

[7] Austerity is a form of voluntary deflation in which the economy adjusts through the reduction of wages, prices and public spending to restore competitiveness, which is (supposedly) best achieved by cutting the state's budget, debts and deficits

to a conjunction of procedures, inclusive of discrepant accounting and off-balance-sheet transactions.

Besides, the adoption of the new currency led to very low and similar interest rates for many Eurozone countries of even large different credit worthiness during years preceding the crisis. As a result, creditors in countries with originally higher interest rates given the weak currencies suddenly had the benefit of much more favourable credit terms. The assumption was that the European Central Bank would cover each outstanding debt issued by a member country since they were all in the same new Euro system. Consequently, European periphery countries were completely endowed with Germany's credit rating. The historically high borrowing costs of these countries drowned. For instance, Greece's borrowing costs passed from approximately 20% on a ten-year bond before the introduction of the Euro to around 4% in 2005, resulting in more borrowing. Since Greece was borrowing more easily, money became more abundant, financing both investment and consumption, which stimulated government and private spending and led to a financial and economic boom, as well as a housing bubble in some countries such as Spain and Ireland.

Furthermore, trade imbalances were raising. Only German trade surpluses increased as a percentage of GDP after 1999, while the deficits of France, Spain and Italy worsened. A trade deficit necessitates a corresponding influx of capital to fund it, which can drive down interest rates and stimulate the creation of bubbles. As noted by Nobel laureate Paul Krugman in an article for the New York Times (2009), "For a while, the inrush of capital created the illusion of wealth in these countries, just as it did for American homeowners: asset prices were rising, currencies were strong, and everything looked fine. But bubbles always burst sooner or later, and yesterday's miracle economies have become today's basket cases, nations whose assets have evaporated but whose debts remain all too real."

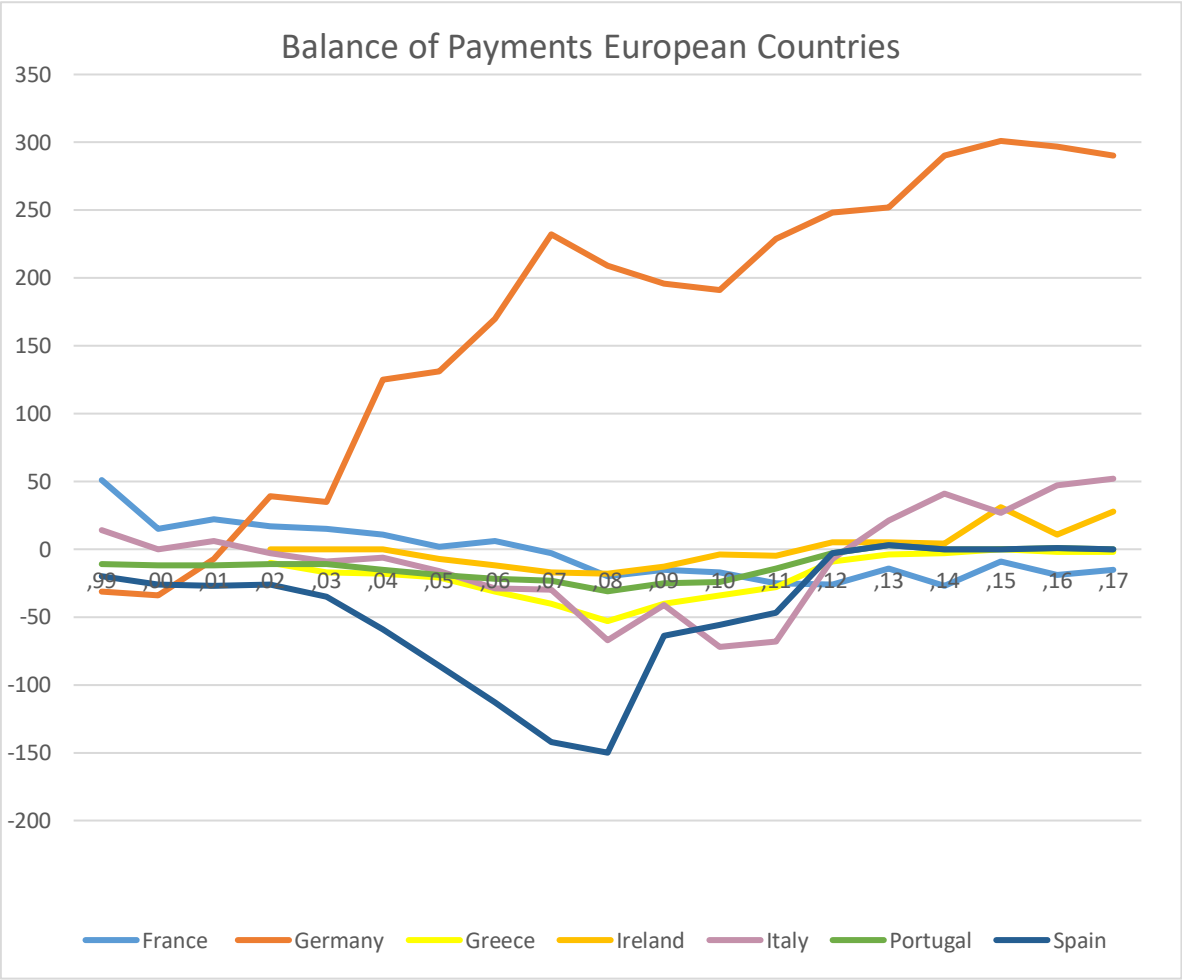

Fig.5 *Balance of Payments BPM6*, source: Organization for Economic Cooperation and Development Stat

Trade surpluses were caused by a gap in productivity, which was widened by a raise in labour cost after the investment boom. (Blyth, 2013) To make matters worse, Eurozone countries with sustained trade surpluses (i.e., Germany) do not see their currency appreciate relative to the other Eurozone nations due to a common currency, keeping their exports artificially cheap, and increasing the gap. There is a 2011 rule in Europe, called Six Pack, according to which a country cannot have a trade surplus to GDP above 6% as a three-year average. The trade surplus of Germany has been between 8 and 9% for years but no institution has ever sanctioned Germany, nor even menaced to do it. This is not fair because if Germany had maintained the Mark, its currency would have grown in value by an estimated 40%. This is

enough to explain German exports boom. Current account deficits are financed with capital accounts surpluses. The capital flows could have been invested to increase productivity in the peripheral nations. Instead capital flows were squandered in consumption and consumptive investments. Columnist Thomas L. Friedman wrote in June 2012: "In Europe, hyper connectedness both exposed just how uncompetitive some of their economies were, but also how interdependent they had become. It was a deadly combination. When countries with such different cultures become this interconnected and interdependent — when they share the same currency but not the same work ethics, retirement ages or budget discipline."

A big problem of the structure of the European Union emerged. This problem is caused by a structural contradiction within in the Eurozone system. The explanation given by Stiglitz (2016) is that there is a monetary union (one common currency) without a fiscal union (e.g., different taxation, pension rules, and treasury functions). Moreover, the structure of the Eurozone system does not allow for quick response, since it requires the unanimous agreement of the 18 member-states for a decision making process.

The European Union was already showing its problems when the US Crisis reached Europe. Originally, the crisis affected Europe's largest economy, Germany, in mid-2007. After suffering losses in the US subprime market, Deutsche Industriebank and several private regional development banks were easily rescued by the government. By the end of 2009, German banking system was healthy. Germans were nonetheless worried about how the global financial crisis could have affected their growth machine - exports. In fact, in the last quarter of 2008, German exports declined of an overall 8.1%. In any case, even this problem did not last long. German exports quickly rebounded thanks to a strong demand in Asia that balanced declines in the Euro Area.

The crisis left German without too much damage, but it was going to hit hard the peripheral countries. This was caused even by a financial mismanagement of the European Central Bank, which acted wrong from the very beginning under the chairmanship of Trichet. Being concerned only about inflation, the ECB has been completely useless, if not harmful. As noted by Roubini in an article of "Il sole 24 ore" (2006), "In the past the ECB erred, like after 2001 when it did too little and too late. If the ECB focus only on inflation, it will make a serious mistake." When the crisis reached Europe, the individual states, following the American example, embraced Keynesian economics, with the exception of Germany and the European Central Bank. Neoliberalism seemed in danger. Neoclassical policies are exclusively interested in providing stable prices and avoiding inflation. This did not seem the right recipe in a period in which deflation was the problem. Furthermore, neoliberal ideas considered the crisis not possible to happen, while according to Keynesianism, by letting the market regulate itself, such events were inevitable. Keynesianism was the obvious answer to the crisis. As a consequence, it was largely invoked the return of Keynesianism, except from Germany, the biggest European economy, which wanted to halt it. As pointed out by Somma (2014), there are three reasons behind it. First, Germany has been historically afraid of inflation since 1920s. Policymakers have never liked the idea of distributing money, even if Germany inflation of the 1920s had not been the result of monetary stimulus by the Central Bank or expansionary policies trying to stave off a recession. In fact, its origin lay in the financing of World War I through debt. Hyperinflation was even a desire of German government, since it wanted to escape the economic prison of the war reparations agreed in the Treaty of Versailles. France wanted to be paid either in gold or foreign currencies. As the exchange rate was falling, more marks were needed to earn foreign currency, rising further inflation. This was a dramatic period for German. Hyperinflation ended in 1923, when Germany was allowed

to print a new currency, and the debt was rescheduled. This means that inflation is not our economic problem, it is their economic education and knowledge problem. The second reason is that German policy-makers are ordo-liberals. We will explore this topic more later, but the basic insight is that the state regulates but does not experiment or stimulate. Third, success is contagious, and Germany has been very successful with its instruction sheet. Despite the fact that Germany lost two world wars and was completely devastated after World War II, it was able to become the most powerful and largest economy in Europe in few decades. It is thanks to the export of high-quality goods to the rest of the world that Germany became so powerful that it was able to integrate East Germany into its economy and later to regain competitiveness after the financial crisis without much effort.

For these reasons, the return of Keynesianism was seen as a disaster ready to happen whose consequences would have been inflation. As such, Germany refused to sign any more stimulus efforts, actually condemning other European Countries, and going against the pressure from the United States.

One year after the crisis had begun, even neoliberals already forgot the disaster that their ideology had set up. Former Fed chairman Alan Greenspan observed in an interview at the Financial Times that he was forced to reconsider his ideology of markets, even acknowledging the desirability of bank nationalization. However, three months later, in June, he defended austerity being worried about inflation. In an article of the same journal, Jeffrey Sachs believed that it was “time to plan for post-Keynesian era” being the economic stimulus considered as harmful. By mid-2010, German policymakers received the support of the European Central bank. Its chief Jean Claude Trichet said in a famous article of the Financial Times, “Stimulate no more, it is now time for all to tighten.”

Keynesianism was again going to leave room for liberal policies to find a solution for the crisis. Capitalism showed that it was immortal, as ironically noted by Mark Fisher (2010, 32)), “It is easier to imagine the end of the world rather than the end of capitalism”. The ideology that had created the crisis was then supposed to be the solution for recovery.

The Crisis Hits Greece

While the Germans were rapidly recovering, a crisis was about to shock the periphery of Europe. As noted by Blyth (2013, 48), "Greece had long been the problem child of the European periphery". Greek's government in the 1980s and 1990s was under the socialist Papandreou administrations that strived for increasing public consumption and personal income, in an understandable response to decades of violence, instability and political polarization. The government carried out persistently expansionary policies that resulted in widening deficits and increasing debts, given the country's low productivity. As a matter of fact, Greece had not run a budget surplus since 1960. The Greek economy was already far from the parameters imposed by the Maastricht Treaty even when the treaty was signed. Consequently, the decision to adhere to the Eurozone is controversial. Moreover, as a result of the crisis, the former Hellenic country was hit particularly hard since its two main industries (shipping and tourism) are strongly sensitive to changes in the economic cycle. In Greece, debt to GDP had surpassed 100% already in 1994, shooting up after the financial crisis in 2008, and reaching 165% of GDP in 2011. The government put its efforts to keep the economy functioning, but the results were further debt increases. To make matters worse, the low interest rates that Greek debt had benefited since the adoption of the euro skyrocketed, which turned a difficult debt environment suddenly awful, while investments vanished resulting in a lack of liquidity.

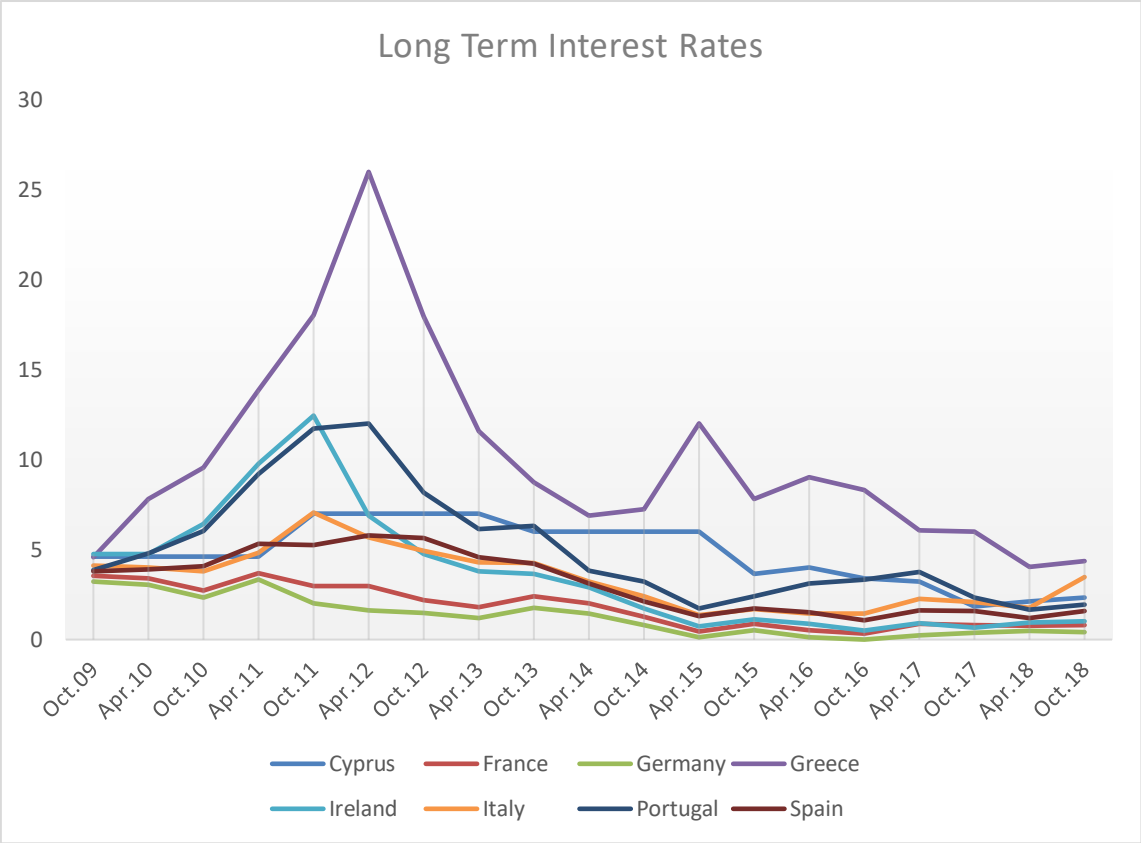

Fig.6 *European Long Term Interest Rates*, source: European Central Bank Statistical Data Warehouse

The ratings agencies underlined the difficult situation and downgraded Greek bonds. For instance, Standard & Poor's reduced Greece's sovereign debt credit rating from A to BB+, causing investors to lose up to 50 percent of their money. In this situation, investors face a dilemma. They risk to produce the very outcome they want to avoid. Investors try to dump the bonds they are afraid are going to fall in value. By doing it, if everyone else will do the same, price collapsing is the result.

The default of Greece was seen as dramatically risky, since the largest banks of central European countries were filled with periphery bonds. This would have been even more dangerous if fire sale spread to Italy, Ireland, Portugal and Spain. France owned 10% of Greek debt, approximately $40 billion, which made investors scared only at saying the word “default”. If the fire sale was to reach even Italy, France owned $350 billion of the Italian

debt. Significant pressure afflicted French banking system and its creditors. This phenomenon can be called financial contagion, and it is caused by the interconnection in the global financial system.

In response to the crisis, on May 1, 2010, an austerity package was announced by the Greek government in order to obtain a €110 billion loan. Greek citizens reacted with anger leading to riots and protests. This is because austerity affects almost exclusively the already-beaten lower-middle class, which is less capable to pay more taxes and relies more on the public support. In October 2011, a second bailout of €130 billion took place through the Troika. It was a tripartite committee composed of the European Central Bank, the European Commission and the International Monetary Fund, which acting like in a new Structural Adjustment Program, demanded the implementation of further austerity measures and debt restructure measures. Greek Prime Minister George Papandreou announced a referendum asking whether the new bailout plan had to be accepted, but he was forced to cancel it since EU partners threatened to withdraw their programmed loans. In November, Papandreou was forced to resign and a technocratic government leaded by Lucas Papademos was appointed. It implemented the requested austerity measures, and the results were as usual poor. Fiscal deficit before interest payments dropped from 10.6% of to just 2.4% of GDP. However, Greek recession worsened because of the big interest rates, and because austerity helped lowering industrial output of 28.4%, 110.000 companies defaulted, and Greek citizen lost 40% of their purchasing power. Furthermore, unemployment rose from 7.5% in September 2011 to 28% in June 2013, and youth unemployment grew from 22% to 62% during the same period. It was even believed that lazy Greek's workers were one of the causes of the crisis in Greece. But this is not the case since Greeks worked about 2,037 hours per years as compared to 1,388 in Germany, and they retire even later.

In the beginning of 2012, an IMF official recognized that imprudent spending cuts were harming Greece. In fact, harsh austerity led to a 17% contraction after six years of recession. In February 2012, a third bailout was provided, but it was not enough since finally Greece defaulted on its debt. This was the largest default in history, and included a law according to which private holders of Greek bonds had to accept a 53.5% devaluation of the nominal value and lower and prolonged interest rates. After the default, Greek debt level fell from approximately from €350billion to €240billion.

These measures of help have been largely criticized. For instance, the director of LSE's Hellenic Observatory argued that the billions of bailouts are not saving Greece but foreign financial institutions. In fact, between 2010 and 2015, of all €252billion in bailouts, only 10% was allocated to Greek government accounts. The rest was used to refinance the old Greek government debt, which was mainly held by foreign hedge funds and banks. It can be considered as a shift from one debt to another. They paid back their debt towards private creditors, replacing it on more favourable terms with new public creditors – the Troika. In fact, as of 2015, almost 80% of Greek debt was owed to public sector institutions, mainly the European Union. This was not an unexpected occurrence as testified by a leaked document of the IMF, dated May 2010. According to this document, the IMF was completely conscious of the fact that the Greek bailout program would have been helpful almost exclusively to rescue private banks – mainly German and French banks. For this reason, it was proposed to further reduce the Greek debt, but French and German refused it.

While the 2012 elections was going to take place, a new word was invented – Grexit. Investors were afraid that an anti-austerity party could have won. However, the narrow victory of the centre-right party restored hope that Greece would continue with its austerity program. In fact, a new austerity package was launched and the Euro group reacted by providing

additional funds of around €10billions. In 2014, Greek economy had slightly recovered, thus it was possible to return to the bond market. Three-year and five-year bonds financed €6.1billions. At the end of 2014, a Syriza-led government won the election. It refused to accept the previously negotiated conditions and harsh austerity, but it was forced to retrace its steps since the "dictators" of austerity, the Troika and the rating agencies, menaced to suspend all scheduled help and to raise interest rates. The new government renegotiated the agreement, but this caused anyway interest rates to skyrocket. On 5 July 2015, a referendum was held, asking whether to accept more help from other European members in return for further austerity measures, Greek citizens decisively rejected it (61% of votes cast).

In 2015, Greece was the first developed country not to make a payment to the IMF on time. Two years later, critical debt-to-GDP ratio reached 179%, showing once again that pro-cyclical austerity makes recovery impossible. On 20 August 2018, as scheduled, Greece's bailouts terminated, but the situation of debt and unemployment remains difficult. Debt-to-GDP is approximately 175% and unemployment is around 19%. Pensions have been cut in to 40% and salaries to 50%. Moreover, the Troika forced Greece to privatize even their most lucrative activities, as the international airports. The main 14 Greek's airports were privatized, and all 14 were bought by Germany, which took advantage of the crisis once again.

Crisis Hits Ireland and Spain

It is strange that Ireland and Spain are in the same group with the Greeks. In fact, unlike Greece, both Ireland and Spain had a low debt compared to the other European countries. For instance, in 2007, Ireland's debt was at 12% of GDP, and Spain's was 26%, while the ever-glorified Germany's debt-to-GDP was 50%. (fig.4) Why, then, were Ireland and Spain hit by the crisis while Germany was not? As seen in the United States, the answer are the banks and a housing bubble. In fact, the two countries are the most understandable example of how this is a private crisis, and not a government spending crisis. As noted by Blyth (2013), "Public debt once again took the place of private debt as states bailed out and recapitalized their banks." As a result, taxpayers had to pay for the disaster that banks had made. And not the richer taxpayers, but the lower-middle class thanks to austerity programs.

Ireland economy did well prior to the crisis. Ireland was able to reduce its debt-to GNP ratio from 112% in 1986 to 25% in 2007, thanks to the exports to countries that were expanding and by upskilling its workforce to take advantage of the influx of multinational corporations that were keen to use Ireland, with its English-speaking workforce and low corporate tax rates, as a gateway to a single market Europe. Ireland's GNP skyrocketed, as did wages, increasing both tax revenues and consumption. The stream of capitals of the so-called Celtic Tiger economy during the late 1990s pushed more people to use property as an investment, generating a massive housing bubble waiting to burst. Even when Ireland entered the Euro Area, the flux of money went on, as happened in Greece. In fact, major central European banks provided the periphery with cheap money. These cheap money combined with low interest rates translated into zero, if not negative real rates, in Ireland and Spain from 2000 onward. Consequently, Irish house prices increased by over 64% in the period 2002–2006. In

order to be able to fund such massive lending, Irish banks had to use the risky US repo markets, using the extremely dangerous practise of borrowing overnight to fund 30-year mortgages. This made Ireland dependent on short-term funding, and when the interbank market froze after the collapse of Lehman's Brothers, even the capability of the Irish banks to service their loans disintegrated, affecting the entire banking system. Fearing the consequences of banks' default, the Irish bailed out the entire banking system's liabilities, and that 400% of assets as GDP on the private sector's balance sheet suddenly became the Irish public's problem. Government debt skyrocketed to over 110% of GDP, and unemployment increased to 14%, a percentage that would have been higher had it not been for emigration.

With Irish interest rates increasing rapidly, it was clear that the Government had to seek assistance from the IMF and EU, resulting in an agreement for a €67.5 billion bailout in November 2010. Combined to €17.5 billion deriving from Ireland's own reserves pensions and reserves, the government collected €85 billion, of which €34 billion were intended to support the failing financial industry. As a response, the government committed itself to lower its budget deficit to below 3% cent by 2015. In April 2011, Moody's downgraded the debt to junk level in spite of all the measures taken. Three months later, the interest rate that Ireland had to pay on its IMF/EU bailout loan was reduced from 6% to 3.5%, and the maturity of the loan was expanded by 8 years. European leaders expected that this decision enabled Ireland to save around €600–700 million per year. Even the interest rate on the €22.5 billion loan owned by the European Financial Stability Mechanism was lowered to 2.59%, the same amount that the European Union pays to borrow from financial markets. Thanks to the enhanced economic outlook, the cost of long-term government bonds fell from its record high at 12%, to below 4% in two years. (Fig.6) On 26 July 2012, Ireland returned to the financial

markets, selling five-year bonds with a 5.9% interest rate and eight-year bonds with a 6.1% interest rate, for a total of around €5 billion. A year later, it regained complete access to financial markets, issuing ten-year bonds with an interest rate of 4.3%. After three years from the launch of the financial support, Ireland was able to leave the IMF/EU bailout programme. Furthermore, In September 2018, Ireland unemployment rate was less than 5.4%, reaching pre-crisis levels.

Spain is a giant version of Ireland amplified through different banking institutions. Rather than having the main banks that control all domestic lending, as in the Irish example, Spain's largest banks (Banco Santander, BBVA) were big international banks, relatively not so dependent on the crisis. The real problem in Spain were the regional saving banks, or cajas de ahorros in Spanish.

As noted above, Spain had an extremely low debt level prior to the crisis compared to other major European economies. Its debt to GDP ratio in 2010 was only 60%, more than 60 points less than Greece, Ireland or Italy and more than 20 points less than France or Germany.

In the years prior the crisis, Spain was able to deindustrialize efficiently, becoming a tourism, services and banking hub. The problem is that these industries relies on income streams coming mainly from outside the country, and when the market is frozen, several problems emerge.

The size of the Spanish housing bubble was surprising. Real estate was so important in the Spanish economy that construction alone contributed to 14% of employment and 16% of GDP. As a result, when the bubble burst, unemployment skyrocketed from 8% to 25% in three years, and youth unemployment reached 52%. Domestic demand fell by 7 percent while GDP contracted 6.3 percent in the first quarter of 2009 alone.

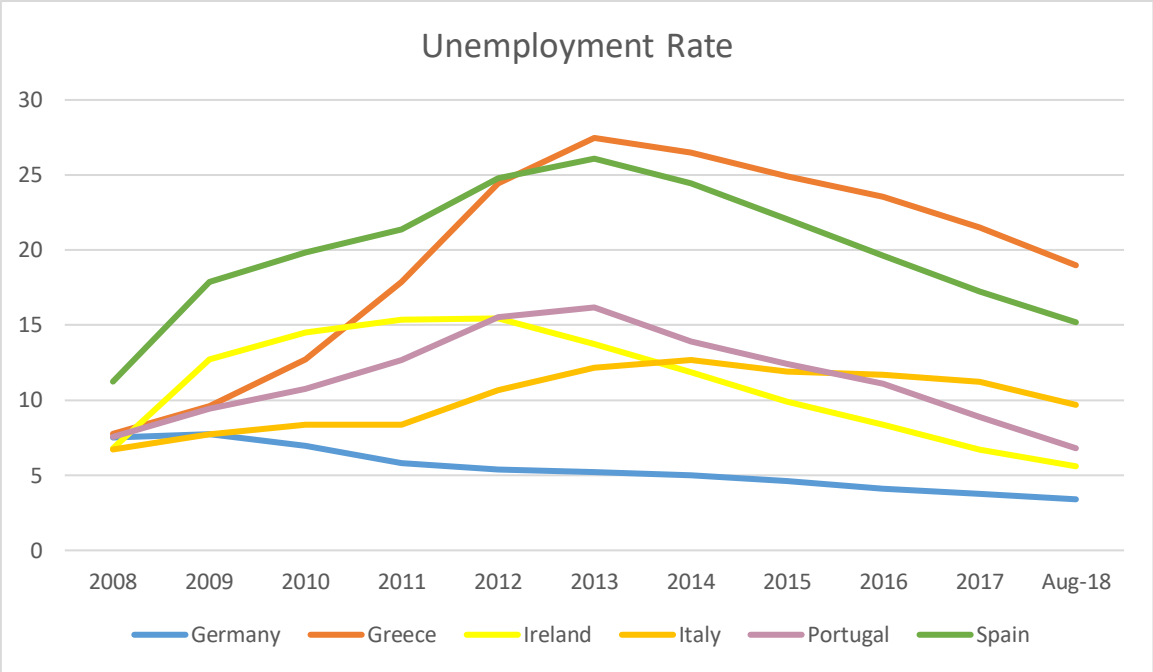

Fig.7 Unemployment Rate (Total % of Labour Force), source: Organization for Economic Cooperation and Development

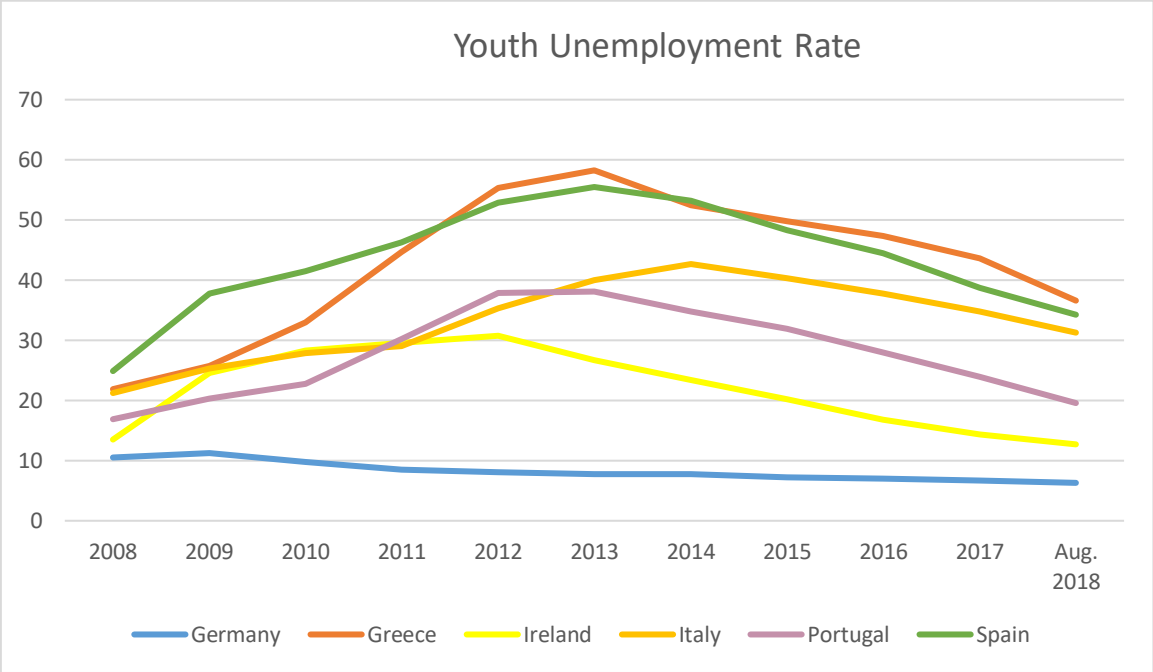

Fig.8 Youth Unemployment Rate, source: Organization for Economic Cooperation and Development

As mentioned earlier, this huge volume of credit did not come from the largest Spanish banks, but from the regional saving banks – the cajas of ahorros. All the regional banks combined made approximately an half of all domestic banking-sector loans. The problems of these banks are similar to those of the U.S. investment banks, they invested in subprime, they were

full of assets that were not coming back, and they were undercapitalized. From the other side of the coin, there was a population indebted over 200% of GDP, one-quarter of which became unemployed. And in contrast to the United States where if you walked away from the mortgage loan, the house would become a problem of the bank, Spanish mortgages are recourse loans. This means that that the bank can pursue the debtor for the original loan until it is paid off and not only for the current value of the property, and mortgagers have every incentive to sit tight and not allow the market to clear, thus making the situation worse by inches. What we have here is the same thing we saw in the United States, the implosion of privately funded housing bubbles—a quintessentially private-sector phenomenon that became a public-sector problem. In order to restore confidence in the financial markets, as in the other PIIGS countries, the government had to introduce austerity measures, which included an amendment to the Spanish Constitution to require a balanced budget by 2020. According to that amendment, government debt cannot overreach 60% of GDP, except in case of a natural catastrophe or other emergencies. Being one of the largest European economy, Spain has been a particular concern for the Eurozone members, which stressed the need for a reduction of debt. Four years after the bursting of the crisis, Spanish deficit passed from 11.2% of GDP to 7.1%. Eurozone institutions even lauded the conservative government of the former Spanish President Mariano Rajoy and his efforts to improve the financial outlook of the country, no matter that unemployment was around 27%. (Fig.7) According to a report of the Financial Times (2013) on the future of the EU, "Madrid is reviewing its pension reform and labour market and has committed by the end of this year to liberalize its heavily regulated professions." Thanks to a restored confidence in the country, on 23 January 2014, Spain formally exited the IMF/EU bailout mechanism. By end of August 2018, Spanish unemployment rate fell to 15.2%., while the debt is 98.30 % of the GDP. It is true that

unemployment fell, but this was provoked even by a deregulation of the job market, which made it more flexible. This caused even job insecurity and a fall in wages, a path that is similar to other southern European countries. As a consequence, Spain might be recovering faster than other economies, but the problems are far from being over.

Crisis Hits Portugal and Italy

Portugal and Italy can be considered a pair as Ireland and Spain. Still, Portugal and Italy are tied together by a combination of old age, low growth, low productivity, institutional sclerosis, corruption and slow judicial system, and not by a housing-bubble-banking crisis. Further, as other PIIGS, they have in common that with the adoption of the euro their interest payments felt since core banks preferred their debts, which offered slightly bigger returns. According to economist Ricardo Reis (2013), this was one of the main causes of the crisis, because, as seen in Greece, the influx of foreign capital reduced the overall national productivity. Even Financial expert Ferreira do Amaral pointed out that the accession to the Euro set the stage for the crisis, as the new currency was seen as too strong for Portugal's industry and economy, taking away from the government the possibility to devaluate or reduce interest rates.

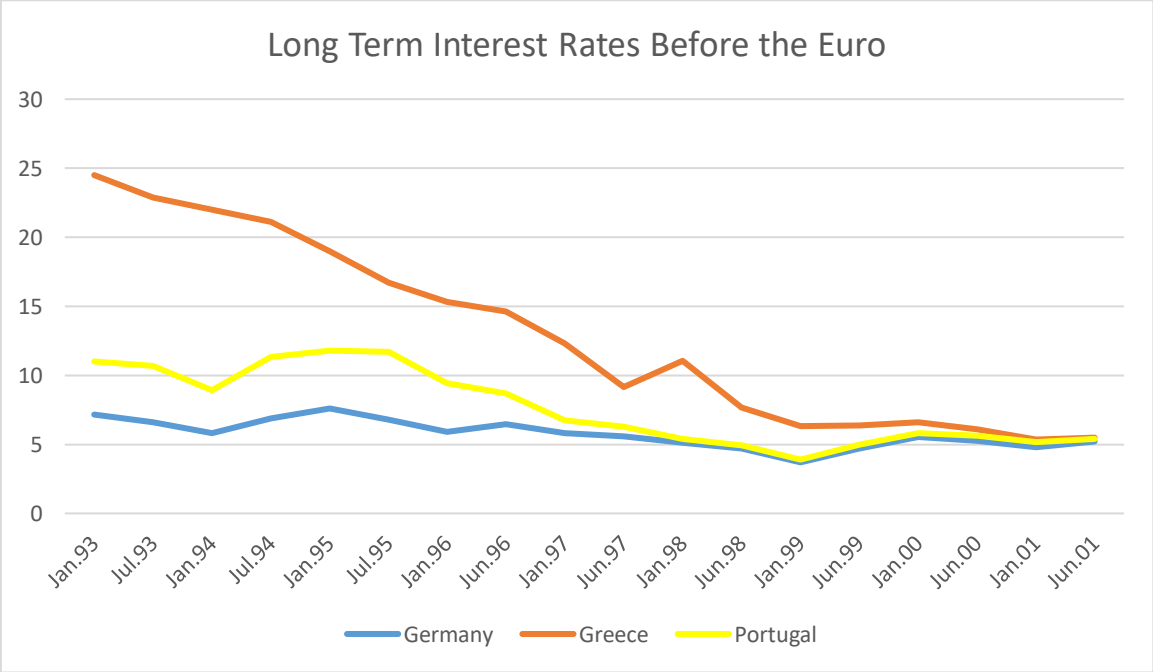

Fig.9 *Long Term Interest Rates Prior to the Introduction of the Euro*, source: European Central Bank Statistical Data Warehouse

Nonetheless, it must be pointed out that Portugal was in trouble even before the financial crisis. Portugal's two main export industries, footwear and textiles, were clobbered by Asian and Eastern European competition in the 1990s. As a consequence, its trade deficits widened and its competitiveness fell. This trend was maintained and even increased following the accession to euro, which caused excessive surplus in core countries and excessive deficit in peripheral countries, as noted by the Portuguese economist Vítor Bento (2015). Young people progressively decided to opt for education since no job was available, temporarily covering the real unemployment rate, and without automatically improving skills. As The Economist magazine observed (2012), "The number of lawyers in Portugal increased by 48% in the first decade of 2000".

Demography aggravates these problems. In 2017, Portugal was ranked 137th out of 230 countries in population growth and 189th in births. The median age of the country was 45, and 18% of the population was already over sixty-five years old. If these issues could have been ignored before the crisis since capital flows from the European core masked the chronic lack of growth, later everyone worried.

As previously noted, Portugal was not doing well even in the period before the crisis. It was a period of economic recessions, stagnation and fiscal austerity. The government was trying to reduce the deficit within the maximum allowed by the Stability and Growth Pact, as done by the Conservative Government of José Manuel Durão Barroso, who introduced policies of structural reforms and harsh austerity since the 2002 election. The new government kept deficit under 3% (otherwise it would have been higher than 5%) both in 2003 and 2004 through extraordinary measures. These new policies were not gladly welcomed by citizens, who in the next elections elected Socialist José Sócrates. Nonetheless, even Sócrates had to implement austerity measures and tax increases. Still, he refused to implement extraordinary

measures, resulting in a budget deficit above 6% in 2005. The next years, his structural reforms worked and the budget deficit reached 2.6%. The financial crisis was still about to undermine the efforts. In the year of the Lehman Brother's default, Portugal did not grow (0%) and reported a 2.6% budget deficit, which reached almost 10% in 2009. During the period from 2008 to 2010, austerity was interrupted, as part of the resurgence of Keynesianism seen above and was then resumed in May 2010. That year financial status remained in a very bad shape, with an 8.6% budget deficit. Meanwhile, Portugal debt-to-GDP ratio sharply increased from 68 percent in 2007 to 111 percent four years later. This made government unable to refinance or repay its debt, and obliged it to request a bailout. As in Ireland and Spain, two banks had contributed to the increase of debt, the Banco Privado Português and the Banco Português de Negócios, since they had invested in the US subprime market, obliging the government to bail them out.

After the resignation of Sócrates, the new government of Pedro Passos Coelho seized power in March 2011. It implemented austerity measures and tried to improve the financial situation of the country in exchange fot a €78 billion bailout from the European Union and the IMF and the approval of the rating agencies, but leading to an increase of the unemployment rate to over 15%.

In the parliamentary elections of October 2015, a left-wing coalition achieved an operating majority with 51% of the vote. The socialist party leaded by António Costa was supported by the Green Party, the Extreme Left and the Communist Party. The new Prime Minister António Costa showed an anti-austerity attitude. In fact, he has blamed austerity for causing "a wave of immigration and intolerable levels of poverty", provoking the reactions of Eurozone countries. Still, Costa believed that spending increases were compatible with EU fiscal targets. As an evidence of this, in 2017, Portugal grew 2.8% (the highest in a decade), and

Moody's upgraded Portuguese bonds out of junk territory. As noted by analyst António Barroso, "Portugal has maintained an anti-austerity rhetoric to ensure the support of its hard-left partners. But it has made an effort to deliver on fiscal consolidation and not lose credibility with investors." The 2019 budget bill approved on 30 October 2018 goes in this direction, and was lauded by Brussels. Prime Minister António Costa reported, "This is a budget that will help reinforce confidence." It might not be easy to restore confidence when 20% of youth are still unemployed, but investors seem confident since there were no big variations in the Spread after the budget bill was approved. Moreover, the Socialists lead in opinion polls by a wide margin for a national election due in a year's time, although the surveys show they are just short of a parliamentary majority which means they will probably have to maintain an alliance on the left.

As noted above, Portugal is tied to Italy by a combination of old age, low growth, low productivity and corruption. In fact, Italian median age is the second biggest in Europe, around 45 years. Even corruption is a severe problem. According to transparency international Italy is placed 53 out of 180 countries, one of the worst of the European Union. As noted by the Italian director of transparency international Davide Del Monte, "High levels of corruption and lack of transparency represent a threat to stability and the proper functioning of a country." According to Unimpresa, corruption would reduce foreign investments of 16% and would increase the cost of contracts of 20%. Companies that operates in a context of corruption would grow 25% less than companies that operates in a context of legality. Estimates of experts pointed out that corruption costed to Italy 100billion of GDP in the last ten years. However, during the last 10 years, Italian perception of corruption has improved, thanks to several manoeuvres such as the Anti-Corruption act and the Severino Act. In the ranking of transparency international, Italy passed from being ranked 72 to being ranked 53.

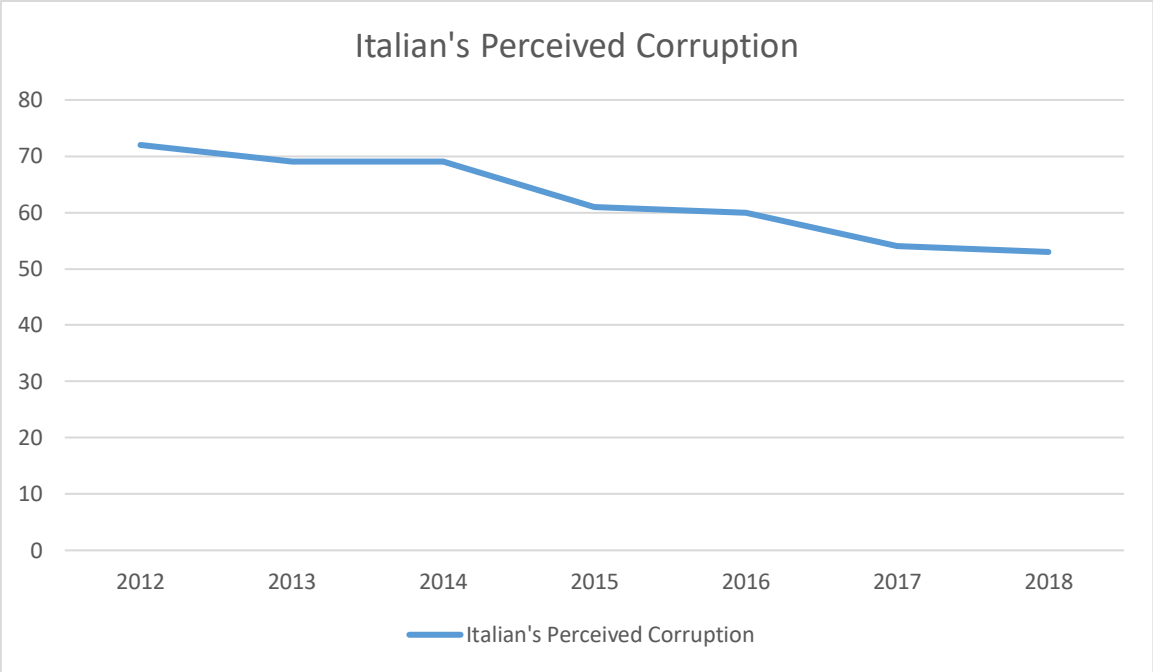

Fig.10 *Italian's rankings of perceived corruption*, source: Transparency International

Even Italian's debt was already big before the crisis. In fact, Italian's debt was above 100% even before the crisis. It was not considered a problem by the market, even if the performance of the economy was very weak. Since 2000, Italian's labour productivity almost did not increase, and even GDP growth was very weak, approximately 1% per year. The manufacturing sector remained lagging behind other European countries. Technology, research and development had received almost no funds from the governments, and the electronics and information technology sectors were left behind. The economic structure was based only on traditional small and medium-sized enterprises. In a world that was becoming increasingly competitive, Italy was struggling to make its voice heard, and the GDP contraction was increased even by the effects of the dot-com bubble.

When the crisis burst in the United States, the Italian financial system came out unscathed from the earthquake of the global finance. This happened thanks to the law degree of internationalisation of the credit system and a weak financialisation of the production system.

Underdevelopment of credit and financial market was an advantage for Italy, but it was not able to prevent the crisis to arrive. The US Subprime Crisis through systemic risk reached even Europe and even the real economy. When the crisis reached European countries, interbank lending froze, and so did investments from core countries to periphery countries. As a consequence, even disposable income and exports significantly diminished. Demand for goods from abroad plummeted and Italy found itself with a shortage of cash. The consequences on the GDP were severe; it dropped of -1.2% in 2008 and -5.5% in 2009. The industrial sector lost a 15.1% and the decrease in sales of the car sector was even around 50%. After the decrease of GDP, Italian's public debt-to-GDP passed from 103.5% to 119%. In response to the crisis, on 29 November 2008, the Berlusconi Cabinet signed the Anti-Crisis Decree (Decreto Anti-Crisi). Among other things, it was created a fund to bailout banks in crisis. The objective was even to encourage production and consumption with a reduction of the tax burden. However, this manoeuvre was almost no effective at all. In fact, in 2010, Italian GDP slightly recovered of a 1.7%, but this was considered as a "bounce" after the crisis and not as a recovery of the real economy. But the worse of the crisis was still to reach Italy. The spread between Italian BTPs and German Bunds passed from irrelevance in 2006 to 176 in 2010. That was still nothing compared to what would have happened in 2011. In 2011, the real crisis reached Italy. The Greek, Irish and Spanish situation was scaring investors, in particular central European Banks. These countries had difficulties to place public securities on the market, and their returns where prohibitive, while in Italy the situation of the securities was still similar to that of the Central European countries. Nonetheless, the deterioration of the Greek situation and the fear that Greece could default or exit the Euro increased the worries about a contagion to Italy, since it had the second biggest debt-to-GDP ratio of Europe. Suddenly that debt became a big problem. The fear of a contagion created

the very outcome they wanted to avoid, and the spread soared. The invisible hand of the market created the new victim. The spread increased each month (except August thanks to an intervention by the ECB) reaching the maximum of 575 points on 9 November 2011. The spread was increasing even because French and German banks were selling large amounts of Italian bonds and because American investment funds were prohibited to invest in Italian securities since they were considered too risky. In the meanwhile, Italian banks did not own the toxic securities created by the bubbles, but owned large quantities of Italian bonds and consequently incurred big losses in the stock market. These difficulties of the banking system created a credit crunch, with devastating effect on consumption, which made the debt-to-GDP to increase further to 133%. Due to the difficult situation Italian prime-minister Berlusconi was forced to resign, and the head of state Giorgio Napolitano nominated Mario Monti to create the new unelected government, which seized power on 16 November 2011. It was a technocratic government, and it was a puppet government of the European Union, where the decisions were taken more in Berlin than in Rome. After one week from the trust to the government the new-prime minister met Nicolas Sarkozy and Angela Merkel (they already had several meeting with Berlusconi, in one of which they famously ironically smiled talking about the Italian's prime-minister) with the objective of discussing Italian's future.

Finally, the technocratic government implemented the Save-Italy Decree (Decreto Salva-Italia) on 4 December 2011. Obviously, it was about austerity measures. No expansionary policies were introduced, on the contrary the objective was a balanced budget. Furthermore, it was introduced a municipal real estate tax (IMU) and a wealth tax on financial assets, while the funds for local authorities were cut. The most famous point of the decree were the pension reforms (Riforma Fornero). It was increased the retirement age to 66 years for men and 62 years for women, a manoeuvre that was announced by the minister Elsa Fornero and her

famous crocodile tears. The decree caused widespread protests from citizens and trade unions, but no results were reached since the government was unelected and continued to use the mantra that the manoeuvres were “demanded by the European Union”. The results of the decree were terrible for Italy, the economy froze and unemployment skyrocketed. The “experts” put Italy on the brink of collapse. Only the spread slightly recovered, but not as much as one would think, since several times it overpassed 500 points even under the Monti cabinet. What really helped the spread to calm down was the too late intervention of the European Central Bank with the LTRO plan. Not surprisingly, only an expansive policies ensured a slightly recovery. Let us remember that the ECB has only one objective, price stability and inflation rate not above 2%. In a recession period, this is not a hard task to be carried out, but it is a dangerous limit to the countries recovery. As a consequence, initially, the ECB decided not to use the quantitative easing (an expansionary monetary policy in which a Central Bank buys government bonds and other financial assets so as to stimulate the economy), but it only bought minor financial assets through liquidity auctions and not the issuing of new currency. At the end of 2011, the ECB began even long-term refinancing, which was to be given to banks and which was called LTRO. Nonetheless, in contrast with a real quantitative easing, money created through LTRO had a maturity date, which was after 3 years. ECB’S stimulus was able to increase financial investments and to calm down the spread, but not to increase productive investments, and consequently the real growth of GDP and employment remained almost static.

In the meanwhile, the Italian government continued to implement austerity measures, further deteriorating the country’s situations. There were several privatizations, tax increases and public spending cuts (decreto privatizzazioni, decreto razionalizzazione della spesa pubblica).

It was implemented even a reform of the job market, with a further deregulation of it, and it was proposed the abolition of the article 18 of the Worker's Statue .

However, the worst act for the economy of the country came from the European Union and it was only signed by the government, the European Fiscal Compact. This treaty was commissioned by the German Chancellor Angela Merkel and the European Central Bank, which were willing to destroy southern European economy once again. Still further restrictions were introduced, after that the Maastricht treaty had already undermined European's recovery. The terms of the treaty were: the obligation to pursue a balanced budget, the introduction of a threshold for the structural deficit not above 0.5% for countries with a debt-to-GDP above 60%, significant reduction of the debt-to-GDP ratio and a coordination of their economic policies with the European Commission. If recovery was already prohibitive, it became impossible. Nobel laureates Eric Maskin, Kenneth Arrow, Peter Diamond, Robert Solow and William Sharpe launched an appeal in which they pointed out that, "The introduction of budgetary constraints represents a terrible choice. And a rigid cap on the public spending will worsen the situation." They argued that, "these manoeuvres will further reduce consumption, with devastating effects on GDP and employment". According to Krugman, the introduction of budgetary constraints would lead even to the end of the welfare state.

While the European institutions were preparing a plan to destroy the southern European countries, Italian industry was sinking, showing how backward it was. For years, Italians economy was based on competitive devaluation of the Lira, hindering innovation, and after the introduction of the euro they took advantage of the strength of the new currency to import cheap raw materials and of deregulation of the labour market to cut costs, still not thinking about innovation. That situation had been haltering economic growth, and it is one of the main

causes of Italian's slow performance. Other elements that contribute to a hostile economic environment are an excessive bureaucratization of administrative procedures, the slow pace of legal processes, a strong tax evasion, and insufficiently effectiveness of organisations and institutions connected with the job market (e.g. job centres). Even the welfare state system is problematic since it protects specific privileged sections of the population compared to other sections completely without safeguards.

Coming back to the Italian political situation, Mario Monti announced that he would resign after the Stability Law for 2013. The stability law did not introduce major changes to the financial structure of the country, and continued with austerity policies and an increase in VAT from 21% to 22%. In March 2013, the technocratic government completed its mandate and the Letta cabinet seized power. He was a member of the Democratic Party, an Italian centre-left party. As usual, the first international meeting of the new prime-minister was with the German chancellor Angela Merkel one week after the election. The first important act of the new government was the "Decreto del Fare". It did not introduce major changes, but it was prohibited the expropriation of the main house, and it was incentivized the construction of new infrastructures (Turin-Lyon high speed rail link). However, it was even cancelled the luxury tax on vessels. Oddly, the only new tax implemented by the previous government that the super-rich had to pay to help the country recovery.

The government entered in crisis at the end of 2013, because of controversy between the Democratic Party and the allied party Popolo Della Libertà about the VAT increase from 21% to 22%, but the budget law for 2014 was implemented without too much trouble. It was decided an important spending review, with minor funds allocated in several sectors of the economy to seek recovery. However, the Letta Cabinet was short-lived. In fact, he was substituted by another member of his party, Matteo Renzi. At the beginning of the mandate,

the Renzi cabinet tried to conduct a modest redistributive and expansionary policy, slightly reducing the tax wedge for the poorest and trying to facilitate the bureaucratic process for the construction of infrastructures through the decree law “Sblocca Italia”. A modest opening to expansive policies was seen even in the budget law for 2015. It was introduced a fund for the unemployed and an 80euro bonus for the lowest income. Even a 90euro bonus for couples with children and low income was established. There were advantages even for companies, thanks to a tax disregard of the IRAP (Regional Tax on Productive Activities). However, this spending investments were accompanied by a spending review that hit municipalities, provinces, regions, ministries, and a wage freeze for state employees, in order to stay within the parameters imposed by the European Union. During 2015, there were important acts that tried to fight against tax avoidance, but they were very controversial, since they seemed to help the previous Prime-Minister Berlusconi in his judicial process.

In the meanwhile, the European Central Bank understood that their manoeuvres were not enough and that the credit crunch was continuing, while they had already used conventional monetary policies (lowering of interest rates and negative interest rates). They had to accept that real expansionary policies were needed. On 22 January 2015, during the World Economic Forum, the President of the European Central Bank Mario Draghi announced that the ECB was going to buy government securities and private equities from March 2015. Consequently, the quantitative easing was launched after 5 years of unnecessary rigid austerity and recession. Better late than never. The issuing of new money was approximately of 60billions each month. The ECB undertook to buy bonds on the secondary market, in proportion to the shares of social capital of each country. The estimate of the new government was that even with the adoption of the quantitative easing, inflation would have been lower than 2%, approximately at 1.5%, and they were right. At the end of 2015, it was approved even the second phase of

the quantitative easing's programme, by establishing an extension of the monetary stimulus, and by lowering the rate of bank deposits at the ECB from -0.2% to -0.3%. On March 2016, the ECB decided, not surprisingly with a German vote against it, to increase from 60billions to 80billions the monthly amount of the quantitative easing. Furthermore, it was decided to maintain at 0% the reference interest rate, and to lower from -0.3% to -0.4% the rate of bank deposits. These manoeuvres of the European Central Bank were more than welcomed; however, it was only a half-step towards Keynes, since they were accompanied by the usual request of austerity and not by a reduction of parameters. Consequently, even the results were only half-effective. As ironically pointed out by the Nobel laureate Amartya Sen in his article "The Economic Consequences of Austerity" (4 June 2015), "It is as if a person had asked for an antibiotic for his fever, and been given a mixed tablet with antibiotic and rat poison. You cannot have the antibiotic without also having the rat poison."

These manoeuvres of the ECB arrived after that the Renzi cabinet had implemented the Budget Law for 2016. It was decided to block the VAT increases and to eliminate the TASI (Tribute for Indivisible Services). This progressive lowering of taxes was accompanied by a lowering of the public spending.

In December 2016, it took place the constitutional referendum commissioned after the Renzi-Boschi Act. The prime-minister gave great importance to the referendum, enough to being available to resign if it did not pass.

The advocates of the manoeuvre believed that the advantages that it would have created were a new and better type of bicameralism, the introduction of a faster legislative process, the saving resulting from the abolition of the CNEL and the reduction of senators, and the overcoming of conflicts between state and regions. While the oppositions, leaded by the Five Star Movement and the Lega Nord, argued that it would have created the risk that the new

senate was useless, a more complex legislature process leading to more and not less time to implement an act, the abolition of the direct elections of senators that would have led to further reduced influence of citizens, and the excessive reduction of local authorities.

Voter turnout was around 65% of citizens entitled to vote, and the referendum was rejected with approximately the 60% of the votes cast. Following the results, Renzi resigned, and a new government, with almost the same ministers of the previous, and leaded by a member of the same party (Paolo Gentiloni) seized power. The Gentiloni cabinet brought Italy toward the 2018 elections. Particularly important, the voucher system, introduced by Berlusconi and expanded by Monti, was cancelled.

Neoliberalism and Austerity

We have been talking about neoliberalism, but where does it come from?

Neoliberalism as a possible remedy to threats posed to the capitalist social order and as a reaction to capitalism's troubles had long been stashed in the wings of public policy. The intellectual history of liberalism arise with most notably John Locke, Adam Smith, David Hume, David Ricardo and John Stuart Mill. The new liberals and the neo liberals used these theories as foundation of their ideology. However, while the new liberals considered the role of the state as both a tool for social reform and a defender of capitalism, the neo liberals believed in the complete withdrawal of the state from its role in the economy. The Neo Liberals ideas spread and created the Austrian School, through which an exclusive and small group of passionate supporters had gathered together around the acclaimed political philosopher Friedrich von Hayek to create the Mont Pelerin Society. The members described themselves as 'liberals' because of their central commitment to ideals of personal freedom. The neoliberal design indicated their devotion to free market principles of neoclassical economics that had emerged in the second half of the 19th century. Still they also held to Adam Smith's opinion that the hidden hand of the markets was the best device for mobilizing even the basest of human desire. The assumption that individual freedoms are guaranteed by freedom of the market and of trade is a cardinal feature of neoliberal thinking, and it has long dominated the US stance towards the rest of the world. Neoliberal doctrine was thus completely opposed to state interventionist theories, such as those of John Maynard Keynes and was not interested in unemployment. Neoliberalism is even the father of austerity policies. In fact, neoliberalism, and the connected ideas of monetarism and public choice theory,

enabled the return of austerity as last idea standing. Monetarism is a set of ideas advanced most notably by Milton Friedman. According to Friedman, government attempts to stimulate economy, only create inflation. Friedman assumed that unemployment is voluntary and not due to a deficiency of demand. In other words, people can choose between labour and leisure, and demand-deficient unemployment does not exist. When the state spend, unemployment falls because workers are attracted by higher wages, trading off leisure against work. However, only money have increased, not the real wages, since even the prices are higher. Realizing this, workers either demand to increase wages (creating further inflation), or they resign from their jobs, bringing employment again to its "natural rate". According to Friedman, the result is that inflations has increased, and unemployment has not improved. Blyth (154) pointed out that, "By giving us a new set of reasons why state intervention to compensate economic downturns can only end up producing inflation, neoliberalism helped naturalize Austrian and ordo liberal ideas, pulling them off the fringe and into mainstream acceptance".

Another full-blown critique of the state coming from the neoliberalism was the Public Choice Theory. This theory assumes that agents inside a state behave no differently from agents in the private. According to this theory, policymakers want to maximize votes, and so elections determine the content of economic policy making. When the new elections approaches, policymakers reflate so as to try to be re-elected. During the 1980s and 1990s even in Italy spread neoliberalism, mainly through the Bocconi University. Departing from public choice theory that shows how democracy produces inflation, economists as Alesina and Tabellini believes that it creates even debt. The basic idea is that competing parties have different preferences concerning the targets of public expenditure. The incumbent party is likely to provide its public goods while it is still in charge, leaving the debt to the successor party. But

even the successor party will do the same, with the result that the overall debt increase is due to the democratic alternation of parties. According to the Bocconi boys, cutting produces a reduction of debt and growth while spending produces debt and inflation. As a result, there is no alternative to cuts. Alesina and Ardanga thinks that, "spending cuts are more effective than tax increases in stabilizing the debt and avoiding downturns".

The Mont Pelerin group accumulated financial and political support in the US, in particular. However, this movement remained on the margins of both academic and policy influence until the agitated years of the 1970s. This is because from the great depression to the 1970s a different type of liberalism, called embedded liberalism (reference to Karl Polanyi) prevailed. Liberalism had brought the world to the brink of collapse in 1929, so it was needed a government action that could resolve the imbalances of the market through institutionalized regulatory processes so as to avoid future crises. Embedded liberalism was even a right compromise between the working classes who asked protections from the calamities created by laissez-faire markets and financial elites with their greed for profits. However, in the 1970s the world changed for the worse. In 1971, with the Nixon shock, the Bretton Woods system ceased to exist, and it was created a system of free-floating currencies and free finance (that will be the main cause of the US subprime crisis). Two years later, the oil crisis created the conditions for reducing salaries and decreasing the power of the working class. Furthermore, after the crisis several countries needed to be helped. At that point neoliberalism started to matter, and after the first brutal and inhuman experiment in Chile with the coup d'état of Pinochet, it reached even the West, particularly the US with the election of Ronald Reagan (1980) which was preceded by the Volcker Shock[8], and Britain with the election of Margareth

[8] In 1979 Paul Volcker, chairman of the Federal Reserve, decided to rise from one day to the next the nominal interest rate in order to fight inflation, and which caused the beginning a deep recession. This monetary policy was not

Thatcher (1979). It gained even an increasing influence within the academy, notably at the University of Chicago, where Milton Friedman prevailed. The academic respectability was underlined by the award of the Nobel Prize in economics to Hayek and Friedman.

Through various "shocks" neoliberalism was imposed in developing and third-world countries, but it spread even in the European Union. It became so mainstream that it was applied even by centre-left government, in the second neoliberalist phase as defined by Stiglitz and Giddens. Examples are the democratic presidency of Bill Clinton, the labourist government of Tony Blair and the Italian's Ulivo of Romano Prodi. These governments did not consider the State as a substitute of the market (Keynesian belief), but albeit conscious of the limits of the market, they accepted the supremacy of it. It was neoliberalism with "a human face" as characterized by Arestis and Sawyer (2005). Neoliberal governments have always pursued a fiscal policy of tax reduction, more favourable for the richest people, under the guise of encouraging job creation. In reality, the tax disregard of big revenues led to a development of lending practises, which favoured the development of extensive financial speculative investment, and eroded the amount of credit available for productive investment. The events listed in the previous chapters show that liberal ideas were a catastrophe for several European countries, and that austerity was used as a weapon to implement unpopular reforms, which have not been working well. It is ironic that Europe, which used to have the world most advanced democracies with developed welfare states and powerful trade unions, has been receiving the same treatment that was previously reserved to Third World low-income countries through the Washington Consensus. However, as shown by the book "The Shock Doctrine" of Naomi Klein, crises are an irresistible opportunity for social engineers,

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accompanied by welfare policies with catastrophic consequences for the unemployed and the weakening of trade unions.

particularly when the authorities are not accountable to an electorate, as happens in the Eurozone, and so citizens have almost nothing to say about the most important macroeconomic policies. The Washington Consensus (as defined by Williamson, 1989) was imposed to third world and developing countries by the IMF. It is sad that the creation of Keynes was then used as a weapon to implement neoliberalism, since it had been created with a very different purpose in a world that still had a fixed rates system and limited financial volatility. According to Keynes, the IMF had to intervene with expansive policies because markets did not work well, but with the Washington Consensus, perspective was overturned. Given the supremacy of the market, the IMF started to subordinate the financial help to specific policies of austerity, which caused disastrous effects. The actions of the IMF were largely criticised by several economists. For instance, the Nobel laureate Joseph Stiglitz accused the IMF of market fundamentalism.[9] But it was again the International Monetary Fund together with the European Central Bank and the European Commission that have used the European crisis as a weapon to implement policies that an electorate would never have voted. These are the policies that can be called austerity, and are extraordinarily similar to the neoliberal agenda of the structural agenda program. They are summarised in the Article IV paper of the IMF and include spending cuts, fiscal consolidation, reducing employment protections and public sector employment, and not taking care about unemployment. The fact that the Troika saw the crisis as an opportunity to implement policy changes can be found clearly in the Article IV consultation with Spain (2010), in which it states, "Empirical evidence suggests that recoveries from economic crises serve as an opportunity for reform." Increasing social inequalities and redistributive effects have in fact been such a persistent

[9] Market fundamentalism is a term refered to a strong belief in the ability of unregulated free market policies to solve most social and economic issues. The term is used by critics of laissez-faire policies to underline what they perceive as a misguided belief.

feature of neoliberalization as to be regarded as structural to the whole project. We can, therefore, interpret neoliberalization as a political project to re-establish the conditions for capital accumulation and to restore the power of economic elites. (Harvey 2005). According to the head of the neoliberal's argument, Milton Friedman, "Only a crisis, real or perceived produces real changes". (Friedman 1982) And Friedman did prepare real changes for the entire world, European Union included.

Policymakers have always been saying that "there are no alternatives" to the measures that led to huge recession and unemployment, citing in a new way the words of Margaret Thatcher. In reality, alternatives do exist. As observed by Weisbrod (2015,2), "Behind almost every prolonged recession there is some combination of outworn bad ideas, incompetence, and the malign influence of powerful special interests".

The crisis has always been characterized as a financial crisis or debt crisis, but the main cause for the prolonged recession and stagnation might be the structure of the Eurozone, with particular concerns about the European Central Bank, which is named "central bank" but turned out to be nothing of the sort. The ECB is a clear neoliberal bias, since it is only concerned about inflation and price stability, and not with employment as each of the other main Central Banks in the world, including the Federal Reserve. Furthermore, the ECB is prevented from one of the most important role for a Central Bank, being a lender of last resort. Citizens of the countries of the Euro area could not understand what they were losing when the Maastricht Treaty was signed. It was the crisis and the following serious recession to show what this union really meant, when governments would have needed to use expansionary macroeconomic policies to restore employment and growth, but they could not. And they discovered that their fate was in the hands of financial experts who are almost completely unaccountable to the electorate and who were ready to use the crisis to implement policies

that an elected government would never sign, if it was not willing to commit political suicide. As famously said by Mayer Amschel Rothschild, “Let me issue and control currency, and I do not care who writes the laws.” In addition, as requested by the Maastricht Treaty, it was asked governments to keep their annual deficits below 3% of GDP. Ignoring what happened in the US, where the recovery was possible thanks to a budget deficit of 10% of GDP in 2010, and 9% in 2011.

The European Central Bank could implement expansive policies when the crisis hit, since it controls a hard currency and so it can create money and keep long-term borrowing costs low, but it refused to do it, afraid of a far and impossible inflation, and willing to take advantage from the crisis. Furthermore, the only country that had a real problem with debt, Greece, had an economy that was less than 2% of the GDP of the Euro area, and as a consequence its debt problems were not so big if the other countries were willing to take care of it and were not afraid of moral hazard. By doing it, Greece’s manageable situation was transformed into a contagious mess. Pro-cyclical austerity was implemented in the PIIGS countries that, in combination with the slowing regional economy, caused the economy of these countries to shrink. This causes government revenues to fall, and as a consequence more steps to cut spending were needed in order to remain within the limits imposed, further reducing economic growth in a vicious circle.

As noted above, the crisis and austerity have caused social differences to increase even more rapidly, but the creation of social differences are one of the main characteristic of neoliberalism. While from the Keynesian perspective taxes increase in proportion to income, and so the more you earn the more you pay, from the neoliberal perspective those who have higher incomes benefit the largest tax benefits. The theory behind it is called trickled down effects, and the idea is that if you give more money to the top, it will benefit everyone because

it would lead to more growth. But it has never worked. Furthermore, income support policies, the fight against unemployment, social and wealth welfare policies, are all policies that would require an increase in the taxation of incomes and financial returns, but they are not compatible with the profit motive of the ruling class. For this reason, for the greed of a few, governments around the world have not been addressing key economic problems, including the persistent unemployment, and they have scarified the universal value of fairness in order to pursue neoliberalism and austerity. Something happened to our sense of values, when the purpose of making more money justifies the means, which during the crisis has meant exploiting the poorest among us. However, by now, it should be clear to everyone that markets are not working as they would be supposed to do since they are not efficient nor stable, that the neoliberal political system cannot correct market failures, that austerity is a conviction and not a solution, and that the economic system is fundamentally unfair. As noted by Nobel laureate Joseph Stiglitz (2012,51), "Capitalism is failing to produce what was promised, but is delivering on what was not promised—inequality, pollution, unemployment, and, most important of all, the degradation of values to the point where everything is acceptable and no one is accountable." Neoliberalism and austerity are useful only for the upper classes. It is becoming increasingly clear the fracture between the haves and the haves-not. Forty-two multimillionaires own the same money of 3.7 billion people. The two richest Italians (Giovanni Ferrero and Leonardo Del Vecchio) owns an estate, which is around 40billion $, that is the same value of the funds which would have been needed to implement the entire Italian draft budget bill if it was not rejected by the EU. According to Lucas Chancel, who is the main coordinator of the World Inequality Report (2018), "Worldwide, between 1980 and 2016, the richest 1% of the world's population earned twice what it was earned by the poorest 50% of the economic growth." In 1978, in the US, the richest 1% earned approximately

400.000$ a year, eight times the average American salary; in 2010, the richest 1% earned 1.101.000$ a year, thirty-two times the average American salary! In other words, the story is this: the rich are becoming richer, the richest of the rich are becoming still richer, the poor are becoming poorer and more numerous, and the middle class does not exist anymore. In fact, the incomes of the old-middle class have been stagnating or falling for decades.

In 2016, the richest 10% of Europe earned 37% of the national income, 41% in China, 46% in Russia, 47% in the US, 55% in Brazil and India and 61% in the Middle East. This ratio has always increased since the 1970s-1980s, namely since neoliberalism was imposed to the world.

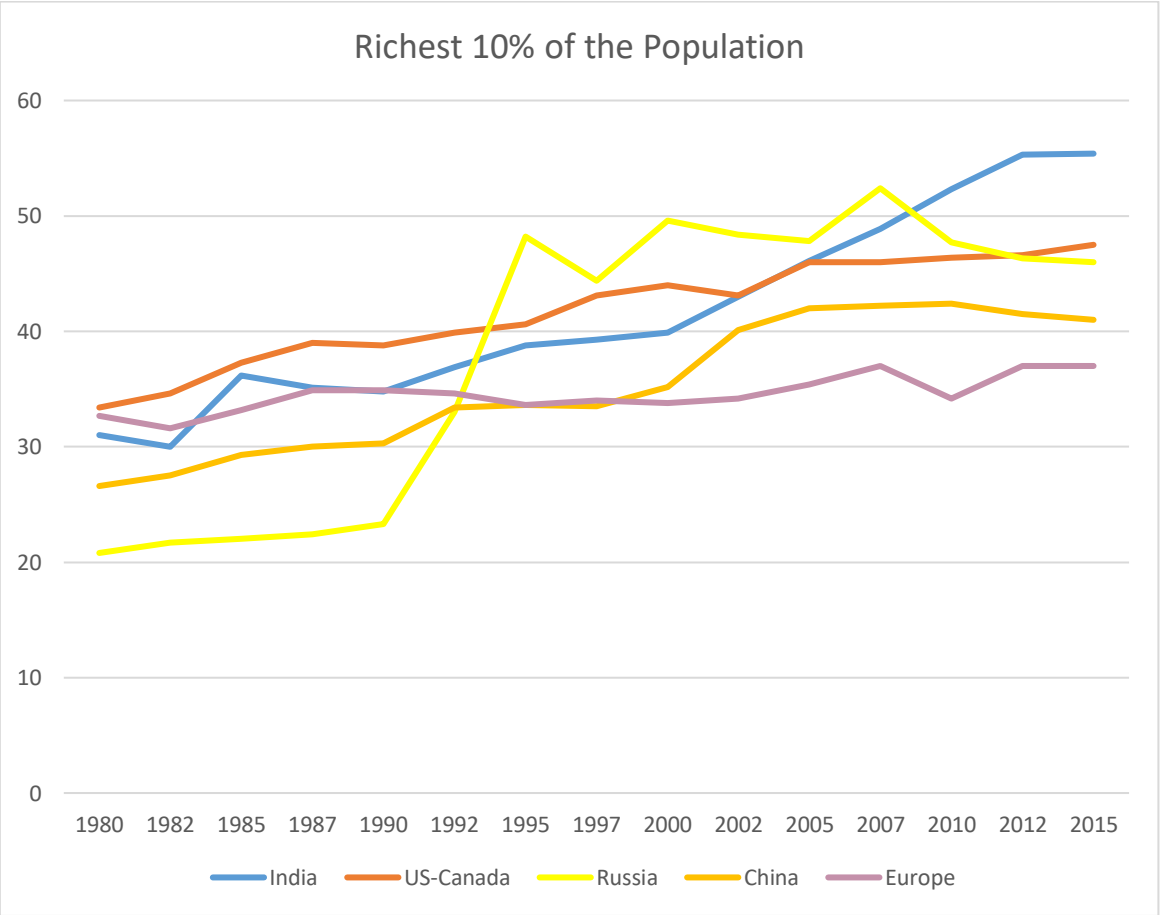

Fig.11 Percentage of Income going to the Richest 10% of the Population, source: World Inequality Report

In Italy, between 1993 and 2013, the poorest 90% of the population suffered a decrease of their wealth from 60% to 45%, with the remaining 55% that goes to the richest 10%; a percentage far greater compared to the average of the European Union.

If the trend remains unchanged, in 2050 the richest 0.1% will control the same wealth of the entire middle-class.

It is clear that neoliberalism has been a catastrophe. But why are there so few protests against it? When the world was fighting against Fascism, Nazism or Communism, everyone knew who was the enemy. On the contrary, neoliberalism is a silent enemy. If you ask an average person, "what is neoliberalism?" it is very probable that he will not give any answer because he does not know it. Mainstream televisions, radios, journals, newspapers has rarely addressed the issue neoliberalism, and the interest of the masses in Economics is always decreasing. Neoliberalism has affected the lives of humans more than any other ideology, but the majority of population does not even know that it exists. The only people that know its existence and that want to denounce it are often criticized as "conspiracy theorists". This makes an opposition to neoliberalism very hard, and despite the fact that some anti-neoliberal economists won the Nobel Prize (e.g. Stiglitz), it is usually difficult to get academic attention when you have unorthodox thesis. The fact that those who have the power (e.g. big corporations, multinationals…) benefits from neoliberalism, makes it even harder to receive funds in order to carry out research to denounce liberalism and austerity.

Neoliberalism might seem distant from our lives, but this is not the case. In reality, neoliberalism and later austerity has changed some of the principal aspects of our daily lives, including the world of work. The many reforms of labour implemented since neoliberalism have introduced new types of workers, non-standard and atypical, who have difficulties in

relating to trade unions and who are without the protections granted to typical workers. But they have eroded the protections even for the very typical workers. Musso (2006) predicted that society had to be afraid of uncontrolled and not protected flexibility of the labour market, in particular when it was accompanied by a crisis of the welfare system. This is because it risks to produce the exclusion of numerous workers, to make it impossible for younger generations to design their own life for instance by buying a house, and to disintegrate all fundamental values. Over recent years, policies of deregulation of the labour market have been implemented with strong frequency in Italy, as the Employment Protection Legislation[10] index shows.

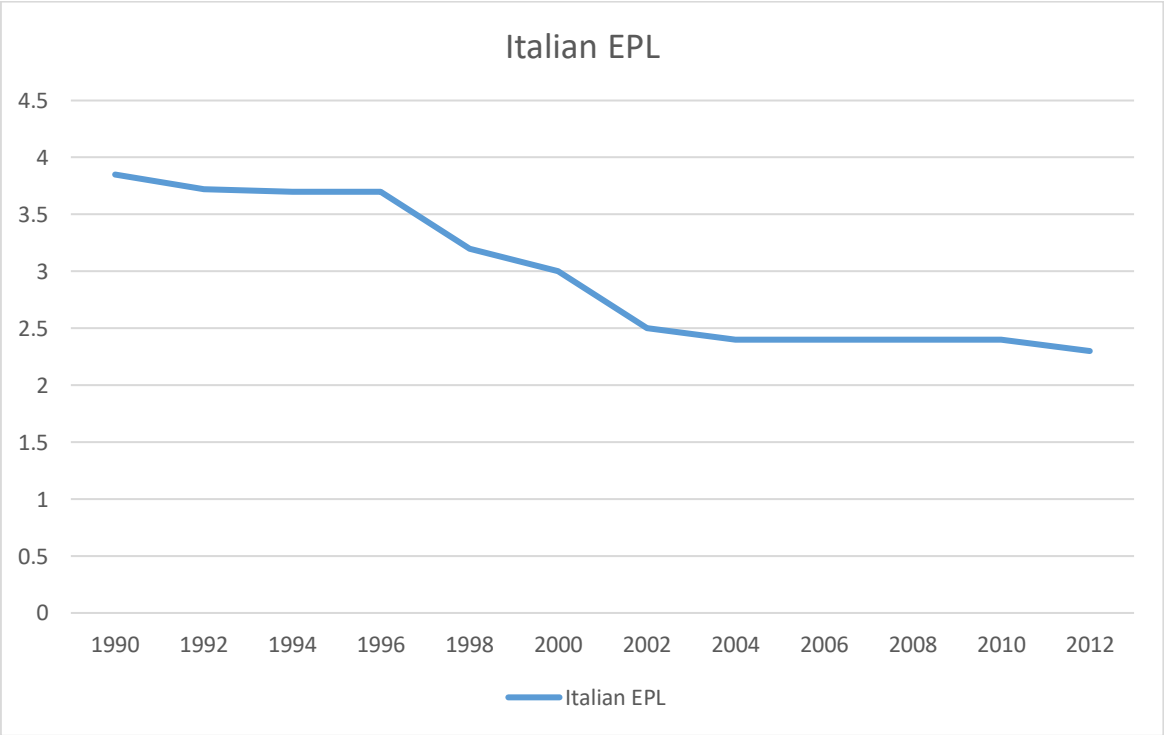

Fig.12 Italian's Employment Protection Legislation Index, source: OECD Indicators of Employment Protection Data

[10] Employment Protection Legislation (EPL) consists of several types of employment protection measures, that can grounded primarily in court rulings, legislation, or customary practice. Protection refers both to regulations concerning hiring) and firing.

There has been a general conviction that deregulation is a necessary instrument to increase employment in a context characterized by increasing volatility of demand. In reality, the economic disadvantages are greater than the advantages, without even taking into consideration the social consequences. Deregulation increases the uncertainty of workers, encouraging precautionary savings and depressing consumption. Furthermore, deregulation allows the companies to gain competitiveness without any effort, leading to a disincentive to innovation. Studies show that deregulation of the labour market creates the adverse effect of increasing unemployment. Effect that is greater when deregulation is accompanied by austerity.

Trying to analyse the steps that led to a significant flexibility of labour market in Italy, the first event to be cited was the implementation of the act n°196 (Pacchetto Treu) under the neoliberal-inspired government of Romano Prodi. That was part of a larger plan coming from the European Union, the European Employment Strategy. The EES had four watchwords: employability, entrepreneurship, adaptability and equal opportunities. The narrative was that an excessive rigidity of a labour market that ensures too many rights to workers (the insiders) tends to exclude a large number of outsiders. The "Pacchetto Treu" followed that direction. There was the introduction of temporary work, it was incentivized part-time work, and fixed-term employment was expanded. The domain of personnel placement opened the door to private sector companies, and temporary agencies strongly spread since then.

In the late 1990s, atypical forms of employment were already taking the lead vis-à-vis permanent employment. Moving forwards to the 2000s, it was the Berlusconi Cabinet to launch a new attack against the rights of workers. It was attacked the Article 18 of the Worker's Statue, that limited the possible redundancies. Berlusconi considered it as one reason why employers were not prone to hire people. However, the general climate was

absolutely not favourable. The biggest supporter of deregulation, the labour attorney Marco Biagi was killed by the terrorist group “Nuove Brigate Rosse” because of his ideas. Moreover, on 23 March 2002, three million people protested against the abolition of the Article 18. That article was not eliminated, but the Biagi Act was approved in 2003, further opening the door to the flexibility asked by Europe. After the implementation of the act, fixed-term employment could be used for any need of technical, productive, organizational or replacement nature. Temporary employment (defined as Somministrazione di Lavoro) was further incentivized and on-call contracts, job share and apprenticeship were introduced. It was then extended the importance of temporary agency.

In 2011, Berlusconi received the famous letter from the European Central Bank signed by Trichet and Draghi. Among other things, Italy had to further reform the wage bargaining system. After the resignation of Berlusconi and the creation of the technocratic government of Mario Monti, the minister Fornero produced the act 92 of 2012, further implementing deregulations. Finally, the jobs act introduced by Matteo Renzi was the last attack against the labour market. Most importantly, there was the replace of the article 18 of the Worker’s Statue about wrongful termination of employment. The new rules excluded the reintegration of workers, while they provided for a financial compensation.

As we have seen, neoliberalism has influenced our lives more than we think. And it could even be sustained that it reached even our minds, creating a society of the free market. We have been granted several freedoms, but this could be the moment in which we are more trapped. Trapped by individualism and greed, driven to competition where those who show off the greatest wealth are considered the winners. We feel free, but only if we follow the freedoms imposed by the trends, and so needs are created; the need to have the newest smartphone, the need to wear fashionable clothes, or the need to take the most exclusive

holidays. And the judge of this competition are usually the social networks, that through likes determine the value of people. In this way, we become goods in the free market, easily replaceable, so that the market does not stop and continues to create new needs, while consumerism go on with its life. And so people are only goods with a deadline, living in insecurity and in the certainty of being substitutable, as the deregulation policies clearly illustrate. However, it comes as no surprise that when appearance leads the world, the nature of things is ephemeral, and not stable as the real value of things. Neoliberalism taught us that in a free market, everyone can compete, and there are winners and losers. Winners are those who owns large sums of money, while losers are the poor, the unemployed, those who are not willing to adapt to the market. This is the reason why we need to fight to get the first of the new IPhone placed on the market, so as to be winners, since to the losers no one pay attention. The losers must sacrifice, they have to accept austerity an their unsecure job, even if they are multiple PhD, because to have winners, losers are needed. In 1930, Keynes predicted that, within 100 years, the world would have had a GDP five times bigger, and that we would be working only 15 hours a week. He was right about the first one, but he was wrong about the second, since he did not consider the insatiability of human desires and the competitive consumption. Keynes could predict how the economy would be, but not how it would be distributed. Indeed, in the midst of the utter individualism, in which we have to count only on ourselves and to demonize external aid, as the public spending, there is no time to help others, those in need.

In this study, it has been maintained and it will be maintained in the next chapter the demand, and so consumption, is the fundamental push for the economy. But we have not been interest in where this consumption comes from, since often it becomes consumerism, which can be considered a disease of the society where we live. It should be remembered that not always

economic values reflect the general welfare of citizens. They are definitely and important indication, but not necessarily definitive. In this study, it was underlined several times, the importance of economic growth, and so of a GDP increase, and we can be sure of this importance, since fundamental values such as employment depend from this. Nonetheless, we should underline even the fact that GDP is an economic indicator sometimes disconnected from reality. First of all, it does not determine how wealth is distributed, and we know that there is an unequal distribution of it. Moreover, there are problems in the GDP calculations, since expenditures that indicate the presence of discomforts, for instance expense on national security to fight growing crime or expenditure on environmental protections to fight climate change, increase the GDP even if they show a problem. There are then activities that create more negative externalities than welfare. A perfect example of this is pollution, in which in order to pursue an economic interest, we give away the health of the planet where we live. Another example is the privatization of beaches, which give a cost to what was free. Not to mention the stress of workers, who are forced to work more and more hours. All these examples demonstrate that we must be careful to believe that an economic growth is always accompanied by an increase in welfare.

After this reasoning, it can be argued than to survive in this society, we could surrender to neoliberalism, by becoming a neoliberal subject with all the features that accompanies them:

1) Their main goal is economic entrepreneurial freedom;

2) They are a competitive, entrepreneurial creature;

3) They are materialistic and they focus on profit and productivity;

4) They value leisure, success and money generation;

5) They only take responsibility for small group of friend and family;

6) Freedom is the freedom to choose market options;

7) They perceive themselves as rational economic actors;

8) They emphasize self-responsibility and self-initiative.

Or we could continue to believe that a brighter future exists, a future where altruism and solidarity have they role they deserve. We can keep fighting for our world, so as to eliminate social and economic injustice, knowing that alternatives exist.

How to emerge from the crisis with Keynes

Up to this point, this study have had the objective to describe the causes of the crisis into which we are living, and the way it has developed. It has been even largely criticised neoliberalism and austerity, which are seen as key culprits of the current situation. It is now introduced the most crucial part of this thesis, for the purpose of demonstrating that alternatives to the crisis exists and have ever existed. In other words, this chapter is about proposing a different economic strategy. Our starting point is John Maynard Keynes, consequently Keynesian policies. Before talking about the present situation, it should be remembered that Keynes had to deal with austerity plans during his life. He lived during the Great Depression, when austerity created the same damages that it has been doing nowadays. He had even a role as official representative of the British Treasury at the Paris Peace Conference. Keynes completely attacked that treaty, and his book "The Economic Consequences of the Peace" was about the consequences of imposed austerity. In fact, that treaty was about what Germany had to do and what it had to pay to the victors. It was imposed an unrealistic burden on the German economy, similar to the burden that Germany is now imposing on indebted countries, and Keynes predicted that that burden would have ruined German economy, but even European economy because of the thesis of interdependence. Keynes even predicted that the treaty would have led to a desire for revenge from Germany. Keynes played an important role even in the Bretton Woods conference, even if the United States took the lead during the negotiations and imposed their willing. Keynes argued that a free floating market was dangerous, he created useful institutions (if they had worked as they were meant to) such as the International Monetary Fund and the World Bank, and he had

clever and interesting ideas that were not accepted, as the creation of a global currency: the Bancor.

It was the end of the Bretton Woods system that put the world at the mercy of the animal spirits of capitalism, and that created the conditions for the crisis in which we are struck.

Keynes did not agree with the traditional economic thinking, based on the Say's law, according to which the offer creates its own demand, and so it is the starting point. He argued that the level of income of a country, its GDP, and consequently the level of employment depended only on demand. Then it is the demand of consumers and other actors that leads companies to produce more and to recruit more citizens. This theory is called "principle of effective demand", and it clearly clashes with austerity policies, since austerity policies tend to destroy demand, affecting the sections of the population more inclined to consume. The lower class, the middle class and the working class are those who really push demand, but they are even those who are worst hit by austerity, since they are more dependent on public spending and they are most effected by a tax increase. On the contrary, the wealthiest sections of the population are the least affected by austerity, but they are even the least likely to consume, since by having excessive quantities of money, they tend to save. Indeed, the coin can be accumulated, and this causes a demand shortfall and the resulting fall in production and high unemployment. Keynes believed that, "Whenever you save five shillings, you put a man out of work for a day." Thus, according to the paradox of saving, it involves a fall in demand, and consequently it would be desirable a high taxation of the richest.

Keynes was then very concerned about full employment. Unemployment is the worst problem of the society in which we live, and despite the fact that that problem is extensively discussed, no policies to fight it are implemented, but on the contrary, the European Union forced indebted countries to implement policies going in the opposite direction. Even the society in

which Keynes lived was characterized by high unemployment, being in the midst of the Great Depression. Keynes claimed that, “The outstanding faults of the economic world in which we live are its failure to provide for full employment and its inequitable and arbitrary distribution of incomes and wealth.” Before the Keynes’ theories, the traditional economy did not consider possible that the market could generate a situation of not full employment. Instead, according to Keynes, such a situation, a stable situation of high unemployment, was possible. It happened when a stable production was produced for those who still received incomes, while those who were unemployed and the companies that were forced to close down were left out from the system. In other words, a situation, similar to the one we are living, in which there are citizens who live in normal conditions while others are completely out of the picture. What is worse is that this is a situation of equilibrium, this is not transitional, so it is needed that the policymakers intervene with expansionary policies, those that are demonized by the European Central Bank, while if they continue with the recessive policies of austerity, that awful situation is condemned to last a long time.

Keynes disagreed even on the idea that unemployment tend to increase in times of crisis because workers do not accept lower wages. On the contrary, he thought that in times of crisis, workers would accept all kinds of works, but the works are not available. He even considered a problem the very fact that wages are reduced, another common policy in Europe. In fact, with gradual wage reductions, workers are likely to save more, so as to defend against probable further reductions, then depressing consumption and demand. As a consequence, the advantages created by a greater competitiveness achieved with wage cuts are offset by the decreasing consumption.

Then, how can we emerge from the crisis with Keynes? It is easy to answer this question. It is enough to look at what the European Union has decided after the crisis, and think about the

complete opposite. Considering what was noted above, in order for the economy to recover, it is necessary to increase aggregate demand. In practise, a way to increase consumption is to lower taxes, but not the taxes of the wealthiest since it would only increase savings and speculation, instead the taxes of the lower-middle classes. Obviously, quite the opposite of what was done by the several governments of austerity, where taxes has been increased, and in particular for the lower-middle classes. A second way is to increase investments, by reducing the interest rate on loans. In reality, this was done by the ECB, albeit belatedly. However, since austerity has brought down consumption, companies do not expect further sales and consequently are less prone to invest. They tend to prefer money, in what is called liquidity trap. A third option is to increase exports and to decrease imports. This objective would be easily achievable by devaluing the currency. It would not be a sustainable policy in the long run since it hinders innovation but it is effective to overcome the crisis. Obviously, in the Eurozone, having a common currency and by not being able of deciding the monetary policy, this strategy is unthinkable.

The most effective method to emerge from the crisis according to Keynes is to increase public spending, the very manoeuvre that neoliberalism and austerity have condemned for decades. In fact, through public investments, it is possible to increase demand and create employment, in particular in the sectors where the private has no interest to act. It is no coincidence that the countries that have stayed away from the animal spirits of capitalism and that have not largely privatized under the neoliberal diktat (e.g. Sweden, Norway, Finland) are even the countries that suffered far less from the crisis. According to Keynes, the reason why public spending exponentially increase demand is called Keynesian multiplier. To give an example, if a country decided to supply its territories with high-speed internet, this would increase the productive capacity of companies, and by reducing costs, it would increase competitiveness.

New companies connected with high-speed internet would start business, and citizens would be more likely to consume. Moreover, it would be necessary to develop this plan, by creating new technologies and implanting new machineries, tasks where is required new workforce that increase employment. In turn, thanks to these salaries, consumption will tend to increase. Even the producers of consumer goods will tend to consume more, since they will have sold more. This circle cannot be endless, but in the meanwhile the GDP would have increased significantly. Someone could argue that public investments would increase even the indebtedness of the country, but this is not the case. First, it should be remembered that the significant data is not the total amount of the debt, but the debt-to-GDP ratio, and if the investment if effective, the GDP will grow more than the debt. Secondly, a wealthiest population will increase the ability of the state to collect taxes and decrease the funds to be given to the unemployed and the poor. In short, it is absolutely possible that an expensive manoeuvre brings down the country's debt. An excessive debt is not created by public spending, but by the wrong public spending. It should even be remembered that the economic growth of the western economies in the XX century occurred only thanks to public investments, and not thanks to neoliberalism, for instance during the New Deal and the Marshall Plan.

Furthermore, it is not possible to repay a debt if you do not have the money to pay it, but this is what the European Union expects the European Countries in the grip of austerity to do. That austerity was counterproductive in a time of crisis had already been noted by Keynes. In 1937, he sent a letter to the American president Roosevelt in which he wrote that, "The boom, not the slump, is the right time for austerity." Yet according to the ECB and Germany, or the Italian neoliberal economists Alesina and Giavazzi, austerity can be expansive. It is hard to

understand how this can be possible since austerity reduces the national income, but neoliberals are very good at proposing theories that are completely wrong.

After these Keynesian theories, what can we do to emerge from the crisis?

In the following some of the possible recipes put forward by economists such as Blyth, Krugman, Reinhart, Roubini, Sen, Stiglitz and Thirlwall are listed. These manoeuvres might look impossible since those in power are not willing to implement them, but in practise, they would be completely possible. The ten points to follow are:

1) Being concerned about aggregate demand and not about austerity.
2) Transform the European Central Bank in a real central bank, a central bank as each other of the world, which can therefore issue money to finance the debt and which can be lender of last resort. A bank able to finance even the single countries and compelled to pursue growth and not the stability of prices and inflation.
3) Create a real wealth tax on estate to promote redistribution.
4) Give benefits to those that push consumption, so reducing the tax wedge for the lower class, the middle class and the working class, while increasing the tax wedge for those that harm the economy, the wealthiest class.
5) Use strong public spending to increase demand and employment.
6) Establish a high tax on financial transactions, in particular short-term transactions, which are the most speculative ones, as proposed by James Tobin.
7) Strongly encourage innovation, research and development to increase competitiveness.
8) Encourage the production of green energy in order to become more independent from foreign raw materials, and even in order to fight the climate change.

9) Reverse the trend that led to the deregulation of the labour market, encourage instead the creation of permanent contracts, and increase the bargaining power of workers so that salaries can grow.

10) Reverse the trend that led to strong privatizations and give importance to public companies.

The Current Italian's Situation

On March 4, 2018 Italians voted for the new government. The Five Star Movement, a populist, anti-establishment and Eurosceptic party led by Luigi Di Maio, received the majority of the votes cast, with a percentage of around 33% in the two houses. A significant result was obtained even by the Lega Nord, a right-wing populist party led by Matteo Salvini, which received approximately the same amount of votes of the Democratic party (the previous government), around 18%.

After several consultations and negotiations, the Five Star Movement and the Lega reached an agreement on a government program, and proposed Giuseppe Conte as new prime minister. On 1 June 2018, the Cabinet Conte seized power, being the new Italian government. Particularly important, the role of Minister of Economy and Finances was given to Giovanni Tria, a conservative liberal Italian economist and university professor. The two parties of the new yellow-green government are linked by populism, Euroscepticism, sovreignitism, and anti-establishment - anti-austerity ideals. During the election campaigns and after the announcement of the government, the statements of the members of the two elected parties have given rise to concerns among European Institutions, other European Countries and the market, about the possible euro exit or a more probable departure from the requested austerity reforms of the new government. It resulted in financial stress and an increase in the spread.

It should be noted that the opposition to the liberal system, a system that was introduced in Italy after decades of Neoliberal literature coming mainly from the Bocconi University. And after the participation in the liberal European Union, the submission to the neoliberal European Central Bank, the acceptance of political pressures from the ordo liberal Germany, does not come from a left-wing party invoking the return of Keynesianism, but from a right-

wing party that has important liberal members in its government (e.g.Tria). Consequently, the departure from the European recipe made by the Conte cabinet cannot be considered an attack against liberalism, but a different use of it through populism. The two parties used the dissatisfaction of unemployed, poor and lost generation Italians, and created a new narrative in which they would fight those who are seen as the cause of the situation, European Institutions and Germany. Never mind they want to fight liberal institutions, having themselves liberal ideas and recipes. By now, centrist governments are largely perceived as powerless. They cannot devaluate, they do not have independent monetary policies, they cannot impose capital controls, and they are asked to tighten fiscal policy. It is understandable that citizens are prone to vote the most extreme parties, those who promise to take the power back in their hands, even if that is almost impossible. That happened even in the 1930s, after World War I and during the Great Depression. And this is not a phenomenon exclusive to Italy. In fact, even in France the far-right party of Marine Le Pen received great support, while the yellow vests movement is crowding the streets, and in Britain it was voted to exit the European Union, even if this exit is still controversial.

The idea of the new government was to produce an economic program perceived as anti-establishment, anti-austerity, and expansionary. Obviously, this created a confrontation with the European institutions, which ironically still see austerity as the way to recover, and more cleverly were afraid that the expansionary policies proposed by the government were not the right ones. The ideas of the Conte Cabinet were summarized in the draft budget bill. The budget bill is the most important act of the political economy of a country. It contains public accounts for the next year and the objectives for the following three years. The key points of the draft were: the creation of a basic income for citizens, tax amnesty, flat tax, no VAT

increase, cut of large pension benefits and a revision of the Fornero Law with the so-called "quota 100".

The flat tax is a very liberal manoeuvre, in fact it had been supported even by Milton Friedman. As the usual results of liberal manoeuvres, rich people are those who take more advantages from a flat tax. The advantages of a flat tax should be fewer taxes for everybody (with a consequent less public spending), less tax evasion and tax avoidance, and an easier tax return. In Italy, it should be better called a dual tax since there are two rates[11]. The creation of a flat tax in Italy would be divided in three phases. In the first phase, it concerns the holders of VAT id, with a 15% or 20 % tax depending on the income, and only a 5% tax for new start-ups. In 2020, it will be introduced even a flat tax for companies, and the IRPEF (personal income tax) brackets will be diminished from five to three. In 2021, the flat tax will be reaching individuals, with a common tax of 15% or 23%. This manoeuvre will continue the Italian (and global) process of reducing taxes, in particular for rich people, which passed from 72% in 1971 to 43% in 2015, and now might decrease further. A tax cut for the poor or the middle class may be useful, since it increases the demand and boosters the economy, but a tax cut for rich people has proven completely useless, or rather harmful. When rich people have even more money, they tend to invest them in speculative finance and not in the real economy. Consequently, it would have been more desirable to increase the tax for the wealthiest and not a tax cut. Nonetheless, since it is still unconfirmed how the flat tax will be implemented in 2020 and 2021, we have to wait to understand the true intentions of the government.

[11] It is not possible in Italy to have only one common tax because Article 52 of the Constitution states that the progression of taxation must be ensured.

As regards the “quota 100”, it will be diminished the retirement age, after that Fornero Law had increased it in response to European pressures after the crisis. Workers who are 62 years old and who have 38 years of contributions are allowed to retire. It is clear that “Quota 100” will increase public expenditure, and so opposition from the European Institutions had to be expected. Still, being allowed to retire at the age of 62 should not be considered a privilege. European institutions are disconnected from reality when they pretend that older people continue to work. It is true that pensions are a burden for state coffers, but there are others, more equal ways, to obtain the necessary funds. A higher taxation of high-incomes as mentioned above is certainly an example, and a strong taxation of short-term financial manoeuvres could be another one.

The decision of the new government about pensions clearly shows the populist nature of the two parties, since the Fornero Law was the most criticised point of the austerity plan launched by the Monti Cabinet. From that, Elsa Fornero (the economist who had implement the law) launched a provocation, by claiming that Quota 100 substantially does not change her reform, and that it is only propaganda. She might be right, but she lost credibility again when she dramatically repeated her mantra that, “The reform was needed for the sake of future generations”, during an interview on the TV channel La7, in January 2019. After the reform, youth unemployment reached 43%, and it is still around 30%. Future generations live in uncertainty, job insecurity and are afraid that their efforts will never be repaid. It is not clear about which future generations she was talking about. As a consequence, another mantra should be used instead of Fornero’s one. It is of Keynes’s (1923), “In the long run we are all dead”.

Turning to the income for citizens (Reddito di Cittadinanza), this was the main point of the Five Star Movement’s electoral campaign. It changed its formulation several times, but it is

an income to be given to the poor and the unemployed. These people should be available to carry out a public service, to take part in training courses and they cannot refuse more than three job offers. Special forms of the income for citizens are to be given even to pensioners and disabled. This is the leftmost manoeuvre of the budget law since it implies an important welfare role for the State. No wonder it was criticised by the European Union. Criticism came even from the oppositions who do not believe that this income will increase employment, but who are sure that it will worsen the financial situation of the country. These concerns might be well-founded, but it is always difficult to predict the effects of a manoeuvre. Furthermore, as observed by journalist Marco Travaglio, almost each European country has an income for citizens, and they are working relatively well. An attempt seems to be more than necessary, and it could hardly worsen the situation of the unemployed, since one in three young people is out of work. More justified concerns can be about those left behind by this manoeuvre. Since companies has the incentive to hire people with the income for citizens, there is the real risk that someone will experience an even harder time to find a job.

Finally, tax amnesty. There will be a tax amnesty of disputes under 1.000euros, and the possibility to resolve the disputes with the IRS, by paying without penalties or interests 50% of undeclared incomes. Tax amnesty can be useful because it raises the revenues of the State in the short term, ensuring larger amounts of funds. But on the other side, it is unfair and it offers no solutions for the long term. Responding to criticism, the Prime Minister Conte stated that, “It should not be defined as a tax amnesty, we call it tax breaks”.

After the draft budget bill was made public, an important rejection of it came from the European Union. This showed (if it was needed) that European Governments are not free to choose their fiscal and economic policies, and, consequently, unelected, unaccountable and distant (geographically and mentally) institutions have the final word on Italian’s future. The

manoeuvres proposed by the new government might be wrong and harmful as we have seen, but we need to underline that it is not even allowed to risk, since we all have to follow austerity plans imposed by the Union, which have proved to be completely wrong. After a decade of unnecessary recession, it is hard to accept that the institutions of the European Union give lessons to a new elected government that should be free to follow its path, even if it is harmful. However, we can think about this situation differently. Being part of the European Union and of a common currency means sharing risks and responsibilities, it is understandable that the European Union is afraid of the Italian economic agenda, since it departs from the Union's economic and financial belief, and in its opinion, it could undermine the stability of the entire Eurozone. It is true that the Union's economic and financial belief has proven dramatically wrong for several southern European countries, and that those who decide are unelected and unaccountable, but when you decide to take part of a union you have to follow the connected rules, and Italy decided to be part of the European Union. When Italy signed the Maastricht Treaty, it meant that Italy gave away fundamental financial and economic powers of decision. It can be discussed whether it was a good idea or not, but it was Italian's decision. Furthermore, Italian slow growth and big debt existed even before the European Union, so the Union cannot be considered as the only culprit of the situation.

To continue our narrative, the rejection of the draft budget bill was exposed with a letter from the European Union to Italy in mid-October. It was sent by the European Commission Vice-President for the Euro and Social Dialogue Valdis Dombrovskis, and the European Commissioner for Economic and Financial Affairs Pierre Moscovici. The letter stated that Italy was undertaking, "a serious non-compliance with the budgetary policy obligations laid down in the Stability and Growth Pact". It should be remembered that this pact had been signed in 1997 in order to maintain the stability of the Union, where it was decided that

Countries had to implement fiscal policies aiming to stay within the limits of 3% of deficit-to-GDP and 60% debt-to-GDP. For the countries having a debt level above 60%, it was even asked to decline with a satisfactory pace each year. This pact was later extended with stricter limits with the European Fiscal Compact. The terms of the treaty were: the obligation to pursue a balanced budget, the introduction of a threshold for the structural deficit not above 0.5% for countries with a debt-to-GDP above 60%, significant reduction of the debt-to-GDP ratio and a coordination of their economic policies with the European Commission. Again, these rules seem to be more harmful than helpful. They are not flexible enough, they do not allow efficient expansionary policies and, what is worse, they are ridiculous in a situation of recession since they are pro-cyclical, halting regrowth. Furthermore, these rules do not distinguish one country from the others, even if the might be in real different situations. In general, these rules might be (and are) wrongful, but once they were signed, it is needed to follow them, we cannot be surprised that the European Union warn those who departure from them, and the non-compliances of the Italian government with the obligations of the Pact were found at various points. The net government expenditure was around 2.7%, while the EU rules allowed only 0.1%. The structural deficit would have increased of 0.8%, while a binding recommendation obliged Italy to cut it by 0.6% of GDP. This deviation was defined as, "unprecedented in the history of the Stability and Growth Act". In the letter, it was then observed that, "with Italy's government debt standing at around 130% of GDP, our preliminary assessment also indicates that Rome's plans would not ensure compliance with the debt criterion benchmark, which requires a steady reduction of the debt level towards the 60% threshold".

After the European Union sent the letter, the rating agencies issued their judgment about Italy. On 20 October 2018, Moody's downgraded Italian bonds from Baa2 to Baa3, only one-step

above the junk status. The decision was driven by concerns about the manoeuvre of the government, which leads to a biggest deficit in the next years. “The Government is not going to change its path in spite of the rating agencies and European commissioners,” commented the minister Salvini during a Coldiretti meeting in Cernobbio, adding, “the rating agencies have already failed spectacularly in the past, and they will fail even this time. This is a good manoeuvre and we are not going to change it”. Even the minister Di Maio did not move from his position after the decision of Moody’s. He declared, “I deny any rethink about the 2.4% deficit-to-GDP ratio”.

Six days later, even Standard & Poor’s ranked Italian bonds. They were confirmed to a BBB grade, only two steps inside the investment grade and above the feared speculative grade. However, the outlook (the projection for the future) passed from stable to negative, as did Fitch Ratings. Standard & Poor’s wrote, “The economic plan of the government threatens to undermine Italian growth”. The rating agency lowered the growth forecast from an already low 1.5% to 1.1%, being worried about an impairment in the structural reforms of the past. They even forecasted that the gross debt is likely to remain around 128.5% in the next three years. The downgrades caused the spread to increase, but the effects on the real economy were not too harsh. It would have been different, if Italian bonds were considered into the Non-Investment Grade. In that case, bonds could not be sold to the ECB, and it would have been hard to place them in the market, since actors like pension funds and investment banks are not allowed to purchase them. As a consequence, the spread would have increased dramatically, with severe consequences for the economy. Luckily, this eventuality was avoided, but the Italian’s position does not offer the conditions for being sanguine about the present and the future.

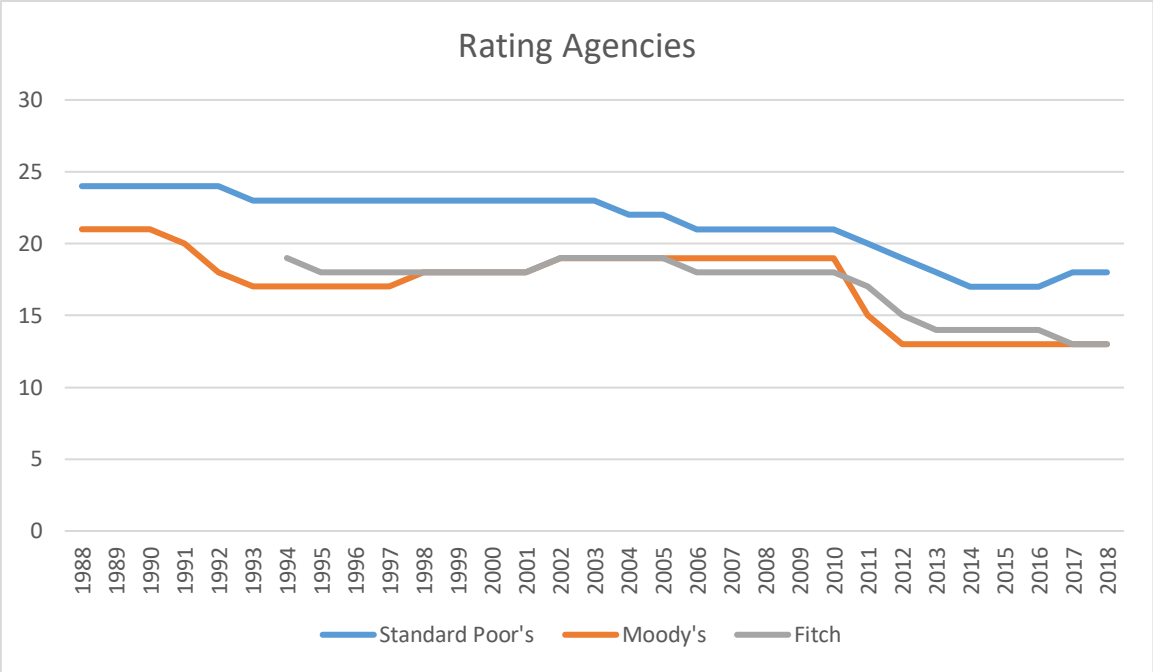

Fig.13 Italian Bonds' Ratings according to the Big Three Rating Agencies, Source: CountryEconomy.com

Bad news for the yellow-green government came even from the issue of BTPs, which represents a signal on financial trust towards a state. In mid-November, in the first emission after the decisions of the rating agencies, there was the biggest collapse of subscriptions since spring 2012, which was only partially recovered during the following days. It was of particular concern the flight of Italian investors, who from March to November passed from 30% to 24%. According to Moody's vice-president Katrin Muehlbronner, "Italian citizens should play a more important role, but they do not seem to have the same attitude of Japanese, who allow Japan to handle the biggest public debt of the world". However, that is not completely true. As noted by professor Di Taranto, two third of Italian public debt is in the hands of Italians, a unique situation in Europe, and the maturity of Italian bonds is usually longer than other countries'. These are two positive situations, because it means that they payment of the debt remain in the same economy and that with a longer maturity there is less risk of speculation. Moreover, private wealth is more than twice the public debt. Thanks to these

conditions, Italian's debt should not be considered as dangerous as European Institutions and rating agencies usually do.

However, criticism at Italy came even from the International Monetary Fund, through their annual consultation. In the "Italy: Concluding Statement of the 2018 Article IV Consultation" (13 November 2018) the IMF pointed out that, "The main problems of the Italian economy are weak social outcomes and low growth. Real personal incomes are at the level of two decades ago; unemployment averaged close to 10% over this period; the living standards of younger and middle-aged generations have eroded; and emigration of Italian citizens is near a five-decade high. The authorities' emphasis on growth and social inclusion, therefore, is welcome." This is of curious reading since it is almost impossible to overcome the problems listed above with the solutions suggested, which, as usual, are structural reforms, fiscal consolidation, liberalizing markets, lower barriers to competition and a firm downward trajectory of the Debt-to-GDP ratio. In other words, again liberalism and austerity.

Since the Italian government decided not to change its draft budget law after the letter of Moscovici, the clash with the European Institutions was unavoidable. It must be remembered that starting with the common rules of the Growth and Stability Pact, each country has to follow specific rules to reach its Medium-Term Objective. Italian government proposed a programme with a 2.4% deficit, while the European Union would not accept a deficit above 2%. Consequently, the EU decided to reject the budget law, and threatened to sanction Italy by initiating the deficit procedure. The Vice-President for the Euro Valdis Dombrovskis said that the procedure could start "by the end of the year". Through this procedure, there would have been continuous monitoring of Italian economic situation and after five years even financial penalties. Furthermore, there was the risk of the suspension of European structural and investment funds. Given these circumstances, the Italian government was forced to

dialogue. The minister for Economic Affairs Tria expressed the hope that, “the dialogue can continue. Italy and the EU commission disagree on several points, but an agreement can be reached”. During a meeting of the Economic and Financial Affairs Council (ECOFIN)[12], even the European commissioner Pierre Moscovici reaffirmed that the Commission was willing to negotiate.

Finally, on 19 December 2018, an agreement was found, and the commission gave the go-ahead for the manoeuvre. Italy lowered the deficit ratio from 2.4% to 2.04%. Dombrovskis stated that, “The solution is not ideal, and it does not resolve Italian long-term problems, but it allows us to avoid the deficit procedure”. Clearly, he cannot applaud a manoeuvre that departures from the much-beloved austerity, but after having agreed on a 3.5% deficit for France (in order to appease the Yellow Vests’ riots), it was hard to continue discussing about decimals with Italy. In this way, an already weak expansionary policy was made even weaker. Consequently, it is almost impossible that substantial improvement of employment and growth can occur.

After the European Union gave the go-ahead, at the beginning of 2019, the budget law came into effect, being published on the Official Journal (Gazzetta Ufficiale), after being approved by the Chamber of Deputies and the Republic Senate. The main points of the manoeuvre seen above were not modified, they were only postponed. The income for citizens will come into force in March 2019, while “quota 100 “in April 2019. It was confirmed that the VAT will not be increased in 2019, but it is likely to increase in 2020 and 2021, and, as one might have predicted given its neoliberal nature, it was even confirmed the flat tax and the tax amnesty. In addition, it was introduced a tax for luxury cars and S.U.V. (similar to the écotaxe that was

[12] The ECOFIN is a configuration of the Council of the European Union, and it is composed of the finance and economics ministers of th 28 EU member states.

criticized by the Yellow Vests Movement in France, and later dismissed), incentives for electric vehicles, the Bolkenstein Directive about beach concessions, the introduction of a 3% web tax, mandatory electronic invoicing, green light for the Trans-Atlantic Pipeline (TAP), and a new Unitary Housing Tax (IMU 2019).

With the agreement reached, the spread and pressures of the financial market relaxed. Moreover, confidence in Italian bonds increased significantly. On 16 January 2019, in the first issuance of the year, there were 35billion of demands, in the face of a 10billion offer. Positive signals came even from short-term securities. The request for high interest rates in the short-term indicates a mistrust in the immediate solvency of a country. To analyse confidence towards short-term securities, it is used the spread between interest rates of 2 years securities and 10 years securities, and in contrast to the BTP-Bund spread, the higher it is the better. That spread passed from a minimum of 60 points, to 250 points.

However, we should not be over optimistic. The Italian situation remains very delicate, the two government parties are frequently in disagreement, speculative attacks of the markets are always a potential risk, and there is the problem of the end of the Quantitative Easing. The ECB decided to stop the quantitative easing for 2019, still reinvesting the bonds already held. Thanks to the reinvestment, the effect of this decision will not be dramatic, but concerns remain for the following years. As a consequence, there is uncertainty about who will refinance the public debt, if the EU is to stop completely the quantitative easing in the future. There would be another instrument, the so-called Outright Monetary Transactions, which allows the ECB to buy potentially unlimited government bonds, in exchange for a pre-established austerity plan. However, it is almost impossible that the yellow-green government would accept new austerity reforms, fortunately. The future will tell us the plans of the ECB,

but it should be noted that it is unlikely that the European Central Bank will leave European countries at the mercy of speculative attacks, even if it has already made lots of mistakes.

For confirmation that Italy is still considered at risk, the International Monetary Fund director Christine Lagarde included the Italian financial situation in the factors that could slow down the growth of the global economy in 2019. It was immediate the response of the minister Matteo Salvini, who stated that, “Is Italy a menace to global economy? Rather it is the International Monetary Fund that is a thread to global economy. It has a history of wrong economic recipes and wrong projections, few successes and many disasters”. Imposing austerity to southern European countries was one of that disasters. During a meeting to celebrate the twenty years of the Euro, even the President of the European Commission Jean-Claude Juncker had to admit that, “Austerity was reckless after the crisis. We should have shown more solidarity.” Adding, “We should not have followed the lead of the International Monetary Fund.” Fine declarations, but in practice nothing has changed. Expansionary policies are still condemned and austerity is still the way to recover.

Conclusions

This study has had the objective to analyse the various facets of the crisis that has been halting Western Countries' growth for a decade. A crisis that started from afar, in the United States, where the free market and the greed for profits created one of the biggest bubbles in economic history. The new financial products had developed a so dangerous situation that turned the impossible into possible, which is why we saw the images that were broadcasted around the world, where the employees of Lehman Brothers with big boxes in their hands were living the tragedy of its bankruptcy. Actually, banks were able to get back to a sort of tranquillity soon after, when the State bailed them out. Even the creators of the bomb system did not serve any sentence for what they had done, and the rating agencies, in spite of their serious mistakes, continue to have a monopoly in the evaluation of the global finance. Those who were not permitted to rest assured were the people who lost their houses, who had invested in securities that were worth nothing, or who had big debts without the possibility to pay them. Even those that lost their jobs after the crisis spread to other sections of the economy.

But then again, who could have predicted this Armageddon? Not the mainstream economists for sure, who were lost in the mythization of the free market, and could not believe that their son created such a disaster. Maybe if we had been listening to some new-Keynesian economist this big meltdown was avoidable, but by then the world was a place for neoliberals, after that the movement, starting from the bastions in the United States and the United Kingdom, had been imposed all over the globe by force and extortion of the International Monetary Fund. And it contaminated even the center-left governments of the European Union, that with its fake central bank and the strong limits imposed by Maastricht had in the meanwhile become the practical example of the ideas of Friedman, Mises and Hayek.

If we had thought that the worst of the crisis was confined in the United States, we were completely wrong. In fact, the crisis would have produced worst victims on the other side of the ocean, where to point out that the good old days are over, the European Union was put face-to-face with all the contradictions on which it had been founded. The crisis became systemic, and that was hardly surprising given the existence of a global market. And so, the investments that used to flow from the centre of Europe to the peripheral countries suddenly stopped, bank's liquidity froze, and the lack of trust towards the position of the other economic actors became widespread. Ireland and Spain found themselves trapped in the same situation in which had been the United States a short time before, and a big housing bubble burst. With their decision to bailout banks, the problem of the banks became the problem of citizens, and the public debt skyrocketed. Consequently, two countries that had had their accounts more in order than Berlin, found themselves compared to the "easy-spender" countries of Southern Europe. Yes, since the crisis was interpreted as a mistake of countries that spent more than they could, while in reality it was because of the countries' loss of power that neoliberalism has created. The crisis born in the United States was the crisis of the private sector, that of neoliberalism and the free market, that of the idea that the "invisible hand" is able to solve each problem and that the public sector is not needed. Even the European crisis was caused by the same ideas that originated in the Mont Pelerin Society, which created a structure completely incapable of dealing with a crisis and demonstrated that austerity is dangerous and harmful once more. Indeed, of all the European countries, only Greece had a real dangerous public debt. Nonetheless, its economy was modest compared to that of the European Union, making the rescue possible, but it was decided not to do it. The Central Europe leaded by Germany was afraid of moral hazard, or simply was willing to take advantage from the crisis to implement structural austere manoeuvres that otherwise would

not have been accepted, and so it was decided to let Greece drown and that the crisis could continue to infect southern European countries. Besides, Germany had the support of the European Central Bank, which having the only and ridiculous purpose of controlling inflation in a period of recession, was able to be wrong about almost every decision since the beginning, when it decided not to lower the interest rates and not to implement expansive policies to curb the crisis. And so, the animal spirits of the market caused fear and speculation to be transferred from Greece to other economies, without any intervention to stop it. In addition to Greece, Spain and Ireland, even Cyprus, Portugal and Italy became "bad States", which had to undergo austerity so as to repay debts. Italian's debt, which was among the highest in the world but no one considered it as a problem, suddenly became extremely dangerous. Oddly, everyone became scared that Italy could default on its debt. While it should be noted that Italy did have a big debt, and that this means that Italy has several structural problems and a backwardness of the industry and competitive ability, it was a debt that for the greater was in the hands of its citizens and with a long-term expiry. Besides the fact that Italian population had a wealth which was twice the debt, making this not so dangerous. It was not because of the debt by itself that Italy has become a problem, but it was because of what the free market did to that debt. The free market is not guided by reason, it is moved by speculation and fear, and this is the reason why the spread between Italian BTPs and German Bunds reached 575, followed by that of the others Southern European economies.

While these countries were sinking, Central Europe and European institution were enthusiastic, aware that they could use blackmail so as to pretend new structural reforms. Then, unelected technocratic governments had the opportunity to put into practice the will of the European Union. The countries that had been part of the cradle of democracy were then under an economic dictatorship. Besides, the countries had decided to sign a treaty, the

Maastricht treaty, which despite the fact that in times of growth and high employment could have been beneficial, in times of crisis it imposed limitations that made recovery impossible. You may think that once they made a mistake, they would not repeat it, but you are wrong. And so even the Fiscal Stability Treaty was signed, which further increased the unsustainable limits imposed by Maastricht. The paradox of austerity has developed in Europe, where, this recipe, used as a treatment, in reality worsened the situation. No surprise, considering that it is pro-cyclical, and consequently in a period of recession, it favours recession.

The results of the crisis and of the strategies to emerge from it were terrible for the middle class who witnesses their purchasing power to collapse, for the poor that have had still more trouble to survive after the spending cuts, for workers who had their salaries reduced and who live in the utopia for a steady job, for the unemployed who have had to wait months or years to find a job, and for the youth who see only uncertainty in the future. It was not so bad for the wealthiest, who have benefited from the same trend started when neoliberalism became global, which have caused the increase of the gap between the richest and poorest to take place more and more.

Alternatives to the crisis would exist, but in the grip of the rules imposed by the European Central Bank and of the ideas that derive from neoliberalism, it is improbable that these alternatives will be considered. These ideas come from the thesis of John Maynard Keynes and include tax cuts and a higher government spending, since expansive policies would enable economy to recover and then the debt-to-GDP ratio would decrease and so would unemployment.

The narrative that Italy would engage in expansionary policies has been present since the election of the new government leaded by Giuseppe Conte, which resulted in confrontations with the European institutions and a stress in the financial market. It should be noted that the

new government is right-oriented, with liberal ideas, consequently the departure from austerity is driven more by populism than by a belief in the expansionary recipes suggest by new-Keynesian economists. After several negotiations, the Italian government reached an agreement with the European Union about the Budget Law, avoiding future sanctions. However, the Italian situation remains delicate, being one of the biggest concerns for the next year.

For the future, it is hard to be optimistic. The European Central Bank has engaged in the quantitative easing for a few years, but this expansionary policy has remained only a footnote in the middle of austerity. As a consequence, to assist a real recovery, it is likely that we have to wait a lot of time.

However, the population of several European countries has started to protest against the system of suffering created by the European institutions. Examples are the Yellow Vests Movement in France and the elections of anti-austerity governments in some Southern European countries. Whether these events can lead to real changes, it remains to be seen, but this is a sign that citizens are fed up with austerity, and that they have started to understand its dangerous paradox.

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