



The Morning Line

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Italy: Too Big to Fail?

SUMMARY

In hopes of calming the world's jitters over its financial health, Italian Finance Minister Giulio Tremonti announced plans to strengthen a \$57 billion austerity package Wednesday. Ray Suarez discusses the country's economic crisis with *Il Sole 24 Ore*'s Mario Calvo-Platero and Harvard University's Kenneth Rogoff.

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Transcript

RAY SUAREZ: For more on all this, we turn to two people who have been following the Italian and the European financial situations closely. Calvo-Platero is U.S. editor of *Il Sole 24 Ore*, a national political and financial daily newspaper in Italy. And **Ken Rogoff is economics professor at Harvard University** and co-author of "This Time Is Different: Eight Centuries of Financial Folly."

Professor, as we reported, the concern has been aimed elsewhere, the emergency meetings, the bailout plans. Suddenly, it's Italy. Why Italy, a now?

KENNETH ROGOFF, Harvard University: Well, I think the proximate cause was the dispute between President Berlusconi and his very well-respected finance minister, Tremonti.

But at a deeper level, people are starting to say, now, wait a second, if Greece is going to default, which in increased last weeks has seemed inevitable where is it going to stop? Why should I keep my money in a bank in Italy at one percent, when I can have it in Germany half-a-percent? And that's putting the pressure on.

RAY SUAREZ: Mario, is that a good comparison? Isn't the Italian economy about six times the size of the Greek economy?

MARIO CALVO-PLATERO, *Il Sole 24 Ore*: Well, in a way it is.

But, you know, I think we also have to start to define what default is, because there's lots of confusion. The markets are very volatile. And investors are worried. So, now, for example, as part of the negotiations, Germany and France would like to see the banks take a bit of a cut in their positions in Greece, which is a fair distribution of a shared cost.

Now, Standard & Poor's and Moody's come out and says, well, if you do that, that -- that is a default. And so people get increasingly worried. So we have to be very attentive at what kind of terms we use. I don't think that Italy is going to default. The European Central Bank is resisting a total default of Greece.

So, we will have to see how that goes. But the situation are very different. Italy has a much stronger and better economy than Greece.

RAY SUAREZ: Well, Mario, other countries in Europe have about a trillion dollars exposure to Italian paper. Even American banks have a trillion billion. Is Italy too big to fail?

MARIO CALVO-PLATERO: Well, certainly it is.

I mean, if you have to think about a rescue package for Italy, no one today has the money to put it up. I mean, let's face it. As you said before, Italy is five times the size of Greece. So, I think that everybody should be quite calm.

Today, the markets were doing much better. It's true, as Ken was saying before, part of the confusion arose because of a fight over -- an internal political fight between Berlusconi and Finance Minister Tremonti. But the decree for a large austerity plan was already passed.

And it was because of this fight that the markets feared that maybe this decree wasn't going to be approved by parliament. Today, the situation is clarified. By Friday this package will be passed. And, you know, Italy is going to go on by adopting this plan.

And, by 2014, it will have a balanced budget, which is going to be quite an enviable situation, if all of this will go according to plan.

RAY SUAREZ: Professor Rogoff, the news of the austerity plan seemed to have calmed really jittery markets, but was it ever thinkable that it would fail? It's got big multinational corporations, a highly productive work force, products people want to buy. Why was there so much concern at the first sign of trouble?

KENNETH ROGOFF: Well, the thing is, there's been a big ratcheting up of the European debt crisis after the last few weeks.

A while ago, people were saying, well, the ECB says Greece needn't default. The Europeans say they're going to back them. The IMF says that it should be OK. And I think nobody thinks that now. The handwriting's on the wall. It's very clear Greece will default. Even the IMF has said that.

And defaults are always partial, by the way, in sovereign debt cases. They're not typically whole. And then people ask, well, what happens to Portugal? What happens to Ireland? Will these countries stay in the euro? And if they leave the euro, they're going to depreciate their new exchange rate; then suddenly Spain won't be competitive.

What happens to Spain? If Spain goes, what happens to Italy? It's a very fragile situation. I think there's been a very weak response by the European authorities, where they're always behind the game. They're always too late. And there's a concern that they really haven't a plan B to ring-fence after Greece defaults.

RAY SUAREZ: Well, Mario, in order for this all to work, the austerity plan has to be accepted and the mechanism, as you described it, has to move forward. We saw riots, wholesale civil unrest in Greece at the sight of an austerity program. Is it going to be better accepted in Italy?

MARIO CALVO-PLATERO: I think so.

In proportion, it's a less strong austerity program than the one that has been adopted by Greece. The opposition apparently is coming to help the government. And it's just going to be a matter of convincing the markets, that are very often overreacting on short-term predictions, that this will be all right.

And, you know, the contagion is true. As Ken was saying, the contagion goes on. And, to a certain point, once -- if the markets will keep going, one after the other to the weak countries, then, in the end, they will even arrive to the United States. I don't know what Ken thinks about this, but the U.S. is certainly not in a very good position these days. And the market will attack it, if we are not going to find soon here a budget agreement to reduce the deficit.

RAY SUAREZ: How about that, Professor? What's the downside for the United States in continued European fiscal unrest?

KENNETH ROGOFF: I think there's no comparison yet between Europe and the United States. And I agree with Mario that eventually, if we do something about our budget deficits and our rising debt, it will come to us.

But right now, everyone wants to give the United States money. We're trying to move proactively to stem a problem in the future. In Europe, we haven't seen the details of a realistic plan, which I think has to involve much more fiscal union, political union in Europe. I don't think the current situation is tenable. I think that's very, very clear.

And it's not yet transparent how they're going to move ahead. So, it's a very fragile situation, even though, at the surface, it's OK. And, by the way, in the austerity package, there's a bank run danger here, that, if you lose confidence, if people lose confidence in the Italian banks, what are they going to do? That's the big risk in Europe.

RAY SUAREZ: Well, Mario, you heard Ken Rogoff describe a situation that sounded like the euro having the possibility of unraveling. Do you think that's a possibility?

MARIO CALVO-PLATERO: Well, there is lots of talk on how Europe is going to deal with this, and there is talk about a two-speed euro, a fast-track euro for some countries with the current euro, and some other countries with a less stringent attachment to the euro.

The question here is -- as Ken was saying, is political. If Europe is able to show one single face on this issue, then it will do much better to convince the markets things are under control. I do not believe for a second that there will be a run on the Italian banks. They're relatively solid.

The saving rate in Italy is very high at the private level. The debt is very high, 120 percent of GDP, but there is a plan to reduce it, of course. So I think -- I mean, you know, we have an Italian, Mario Draghi, who's going to be the next governor of the European Central Bank. I have known him many years.

I'm sure that he will make his mission to keep the euro, maybe a little bit more flexible, but to keep it as one currency. We need large currency flows in the process of globalization.

And can I tell you something?

RAY SUAREZ: Got to go.

MARIO CALVO-PLATERO: If something would go wrong on the euro, I bet that China will intervene and help the euro.

RAY SUAREZ: Mario Calvo-Platero and Ken Rogoff, gentlemen, thank you both.

KENNETH ROGOFF: Thank you.

MARIO CALVO-PLATERO: Thank you.



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Platero is right in that the markets are way too skittish but I think it remains to be seen whether this debt crisis can be resolved by 2014. Also sadly the US is not as far removed as it would like to think...

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