Pressure Mounts for Italy's Monti

Skittish Investors Fear Economic Overhaul Risks Stalling

By STACY MEIGHTY

ROME—Prime Minister Mario Monti’s honeymoon is over.

Italy’s return to the cross hairs of the euro-zone debt crisis has ratcheted up pressure on Mr. Monti to accelerate his turnaround of the country’s moribund economy. But the effort is running up against a rising tide of discontent at home.

Mr. Monti has passed austerity measures including tax increases and an overhaul of Italy's pension system since taking office in November, garnering widespread praise from investors and world leaders.

In recent days, however, the aura surrounding Mr. Monti has faded as investors and lawmakers at home take a hard look at unfinished items on the agenda—an overhaul of the labor market, cuts to government spending and plans to modernize the justice system.

"The Monti effect has waned considerably," said Nicholas Spiro, who heads a London-based consultancy on sovereign debt.

Whether Mr. Monti regains his previous momentum is one of the most important questions facing Europe. Because of the size of its economy and debt—€1.9 trillion ($2.39 trillion), equivalent to 120% of its gross domestic product—Italy would be too big for Europe to bail out.

In a bid to shore up support for his government, Mr. Monti summoned the heads of Italy's biggest political parties to a meeting late Tuesday, reminding party leaders that their backing was crucial for Italy to "overcome the critical nature of the current situation and project an image of cohesion abroad," according to a statement from the government.

Investor fear that Italy could require outside help—compounded by anxiety over Spain and continuing uncertainty over Greece—is driving Italy's borrowing costs back to the levels that preceded Mr. Monti’s appointment. On Tuesday, the yield on Italy's 10-year bond reached 6.14%, compared with a 1.42% yield on ultrasafe German bunds. Rome still needs to sell about half of the €450 billion in debt that Italy needs to roll over this year, said a Treasury official.

At the same time, Mr. Monti’s tax-heavy austerity measures have choked economic growth, causing Italy's economy to contract 0.8% in the first four months of the year.

The confluence of economic and market forces put Mr. Monti on the defensive for the first time in his seven months in office. Mr. Monti lashed back at an Austrian minister on Tuesday for questioning whether Italy might need financial assistance to ride out the crisis.
Labor-law changes making it easier to hire and fire workers need Parliament's approval
€4.2 billion in spending cuts must be found by October to meet budget targets
Bill aimed at fighting corruption in political parties needs parliamentary approval

"I find it completely inappropriate that representatives of other governments in the European Union are talking about the situations of other countries," Mr. Monti said during a news conference, adding that his government was "continuing to work to guarantee the financial stability of the euro zone."

Some of Mr. Monti's biggest challenges, however, are at home where Italians have begun to wonder whether their support for the technocrat leader is really paying off. Italy's deepening recession has poured cold water on supporters who portrayed Mr. Monti as Italy's savior. On Tuesday, Italian Industry Minister Corrado Passera said the European Union bears some of the blame by not acting swiftly enough to stem the crisis.

A poll last week found that only half of Italians supported political parties that form Mr. Monti's parliamentary majority, down from 63% two months ago. Confidence in Mr. Monti among those surveyed fell to 34%, compared with 71% when Mr. Monti took office.

The steady erosion of public support for Mr. Monti's government is also prompting some politicians to question whether Mr. Monti can still push through the tough changes demanded by EU leaders. Last week, Stefano Fassina—head of economic affairs for the left-leaning Democratic Party—said Mr. Monti lacked "the force to forge ahead with other reforms" and questioned whether Italy should hold elections in the fall instead of spring 2013 as planned.

Meanwhile, the country's sprawling bureaucracy of civil servants and functionaries are publicly butting heads with ministers who are supposed to rein in their budgets. The longer political parties maintain their backing for Mr. Monti, the more votes they risk losing when Italians eventually go the polls, said Alessandro Campi, a professor of politics at the University of Perugia. "We're in a situation of pure chaos," Mr. Campi said. "No party wants to get blamed for supporting a government that didn't get big results."

Mr. Monti's drive to overhaul the labor system has made progress. A bill that aims to make it easier for Italian firms to hire and fire workers has passed the Senate, the upper house of the Italian Parliament. However, Mr. Monti had to water down the measure, removing a provision that would have allowed companies to cut workers without having to go before a judge. The bill still faces weeks of scrutiny and possible modification in the Camera, the lower house of Parliament, before it faces a final vote.

"It is still unclear whether [Mr. Monti] will succeed in getting even the latest milder version of the reform packages through the lower house," economists for Citigroup wrote in a recent report, noting that the overhaul "won't go far enough to address the product and labor market rigidities that have plagued the Italian economy for generations."

Italian government officials say the proposed change still goes a long way toward shaking up the collective-bargaining system that has long defined the nation's labor market.

Analysts have also faulted Mr. Monti for relying on growth-sapping tax increases to rein in Italy's deficit rather than slashing government spending. For months, Mr. Monti's ministers have struggled to slash their budgets, sowing tension within the government as ministries jockey to defend their budgets. Italian newspaper reports of squabbling inside Mr. Monti's government have undercut the premier's efforts to portray his ministers as steely technocrats above the political fray.

Italian officials have denied the reports and maintain that ministers are united behind Mr. Monti.

The effort to cut costs continues. In April, Mr. Monti appointed a commissioner to identify €4.2 billion in cuts to government spending. If an agreement isn't reached by October, the prime minister has threatened to raise Italy's value-added tax—a move that would further empty consumers' pockets.

Write to Stacy Meichtry at stacy.meichtry@wsj.com

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