Italian Prime Minister Matteo Renzi resigned Wednesday after nearly 60 percent of voters rejected a referendum Sunday on a series of changes to the constitution that Renzi had staked his premiership on. The referendum's failure and the resignation of the brash prime minister have plunged Italy into political and economic uncertainty, leading many to speculate about Italy's future in the eurozone and the strength of populist movements across Europe.

Renzi said the constitutional reforms would make Italy a more governable country by reducing the size and power of the Italian Senate, the upper house of parliament, and empowering the lower house, the Chamber of Deputies. But for many Italians, the referendum was a way to air their grievances with Renzi and his coalition's failure to deliver on campaign promises, including reducing unemployment and increasing economic growth.

“The personalization of the referendum by Renzi turned it into a plebiscite on his government, causing his own defeat,” Silvia Francescon, the head of the European Council on Foreign Relations' Rome office, says in an email. She adds that anti-establishment forces were able to convince the electorate “that the real purpose behind these reforms was the strengthening of the prime minister
and of his executive, and therefore of the elites.”

Mark Gilbert, a WPR contributor and professor at Johns Hopkins School of Advanced International Studies Europe, based in Bologna, says in an email that the referendum “was more a victory for conservatism—for doing things as they always have been done. Or else, for wanting utopian changes that can’t be achieved, which amounts to the same thing.”

With Renzi stepping aside, Italian President Sergio Mattarella has started the process of forming a caretaker government; a new prime minister could be announced as early as this weekend (http://www.wsj.com/articles/italys-senate-approves-budget-setting-stage-for-renzis-exit-1481119929). Lawmakers from all parties are calling for early elections, which are currently scheduled for spring 2018, to stave off a deeper political crisis.

“I don’t see how this disaster can lead to anything other than prolonged political upheaval,” says Gilbert, who admits to taking an apocalyptic view of Sunday’s vote. A technocratic caretaker government would face similar problems to those of the government of former Prime Minister Mario Monti, who led a government of technocrats from 2011 until 2013 in the wake of the financial crisis but lacked a democratic mandate to institute needed reforms.

The two names being floated to replace Renzi as prime minister are Pier Carlo Padoan, the current finance minister, and Pietro Grasso, the president of the Senate. Padoan is a better choice, according to Francescon, since he “would be a real answer to the concerns, including from markets, regarding the economy and the path of fiscal reforms.”

The referendum results put Italy’s already-unstable banking sector, which is saddled with billions in questionable loans, at an even greater risk. Stocks in Italian banks have fallen, and there are serious questions (https://www.ft.com/content/d5db1afa-bae1-11e6-8b45-b8b81dd5d080) about the future of a planned $5 billion bailout of Monte dei Paschi di Siena, one of the banks at the center of Italy’s banking crisis. Seven other banks are also at risk of collapse (https://www.ft.com/content/e588ea6a-b49f-11e6-961e-a1acd97f622d) if markets don’t stabilize.

One factor that further complicates the political upheaval is an electoral law pushed by Renzi that passed in May 2015. Under the new law, any party that wins at least 40 percent of the vote is given 54 percent of seats in the Chamber of Deputies. If no party reaches the 40-percent threshold, the two biggest parties participate in a second-round vote.
Italy’s populist Five Star Movement, or M5S, led by the comedian Beppe Grillo, is hoping to capitalize on the political instability. The M5S is polling neck-and-neck with Renzi’s Democratic Party and would benefit the most if new elections are held quickly, thanks in large part to the new election law. It is also in M5S’ interest for national elections to be called before the political crisis in Rome gets any worse, since many wonder how much longer the city’s embattled mayor, M5S’ Virginia Raggi, can stay in power without damaging her party (https://www.theguardian.com/world/2016/sep/20/rome-mayoral-crisis-could-hurt-five-stars-national-chances-italy-virginia-raggi). Renzi’s Democratic Party faces an uncertain future.

“The M5S is facing a win-win situation,” says Francescon. “It can now capitalize on the empty space left by Renzi’s resignation and exploit the next political developments and instability through the use of their usual anti-establishment rhetoric.” Even if a technocratic government is formed in Rome, the M5S is in the perfect position to criticize an un-elected government, which it would no doubt frame as elites beholden to Brussels, while presenting itself as the party of real change before the next elections are held.

That has EU officials worried. Between former Prime Minister Silvio Berlusconi’s center-right Forza Italia party, the M5S and the far-right Northern League, nearly half of all Italians support a populist party, according to Francescon. For many in Brussels, Renzi “was a wall against populists.”

Of particular concern in Brussels is M5S’ promise to hold a referendum on leaving the eurozone and reinstating the lira as Italy’s currency. Dropping the common currency “would be a nightmare scenario for the rest of Europe,” Brendan O’Leary, a professor of political science at the University of Pennsylvania, recently observed. A referendum, he added (http://knowledge.wharton.upenn.edu/article/italys-referendum-means-europe/), would “pose a serious choice for Italians. Most Italians like the euro compared to the lira, but they don’t like the ‘medicine’ that comes with the euro.”

Renzi’s commitment to reform in Italy had won him respect across Europe, if not at home, and helped to change the perception of Italy as one of the EU’s biggest so-called slackers. But now Italy’s entire reform agenda is in doubt, and the next government, whether it is technocratic or led by the M5S, “will have fewer tools and less credibility to assert its leverage” than Renzi did, Francescon says.

The full political and economic fallout of Renzi’s failed referendum may take time to emerge. “This
really is a big deal—and not just for Italy," Gilbert warns. Renzi's referendum wasn't Brexit, but it was still another victory for a populist party in Europe. Could France be next?

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