Original Article

Conditionality by other means: EU involvement in Italy's structural reforms in the sovereign debt crisis

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Abstract This article shows the relevance of implicit conditionality in the eurozone crisis, that is, conditionality based on an implicit understanding of the stakes and sanctions involved, underlain by some measure of power asymmetry. The concept of implicit conditionality is applied to the reconstruction of Italy's sovereign debt crisis, and the structural – pension and labour market – reforms introduced by the Monti government, following requests from the European Union (EU). Actual or potential access to EU financial support – carried out through purchase of Italy's bonds to alleviate market tensions on its debt – was the carrot. The threat of having to enter formalized, explicit conditional lending programmes with the International Monetary Fund in order to avoid default was the stick. Market discipline was the operating mechanism that made implicit conditionality effective, and the role of monitoring by the EU was pervasive. Developments described in this article seem to support a revitalization of the fusion hypothesis between EU and member states – at least in the eurozone.
Comparative European Politics advance online publication, 13 October 2014; doi:10.1057/cep.2014.42

Keywords: implicit conditionality; eurozone crisis; structural reforms; Italy; fusion hypothesis

Introduction

This article aims to show the relevance of implicit conditionality within the range of instruments deployed by the European Union (EU) in the eurozone crisis. Contrary to conditionality that requires formalized, explicit covenants, based on Memorandums of Understanding (MoUs), as in the aid packages crafted for Ireland (Dukelow, forthcoming), Greece and Portugal (Theodoropoulou, forthcoming), this sort of conditionality is based on an implicit understanding of the stakes and sanctions

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involved, underlain by some measure of power asymmetry. As the terms of the exchange are relatively indeterminate, compliance is an issue of distinctive relevance for the effectiveness of implicit conditionality, making monitoring all the more important. Pervasive monitoring coupled with external mechanisms of enforcement, such as the sheer power of market discipline, can however make implicit conditionality very consequential and a powerful source of EU involvement in domestic social sovereignty.

Following Sasse (2008), conditionality is understood here as a process, rather than a static arrangement, locked in at a given point in time. Process-tracing is therefore used to elucidate how implicit conditionality operates and unfolds over time. This will be done through the analysis of Italy's acute sovereign debt crisis between July 2011 and June 2012. During this period, as a consequence of contagion risks in the eurozone, the government led by Berlusconi faced a severe market confidence crisis. In order to obtain support from EU institutions – most notably the European Central Bank (ECB) – Italy committed to an array of structural reforms. Inability to deliver led to increasing pressure on the government, which was finally replaced by a new one headed by Monti. Requests from the EU to introduce structural reforms – particularly in pensions and labour market policy – became the new government's roadmap, and their implementation was carefully monitored and scrutinized. Actual or potential access to EU financial support – carried out through purchase of Italy's bonds to alleviate market tensions on its debt – was the implicit carrot. The threat of having to enter formalized, explicit conditional lending programmes with the International Monetary Fund (IMF) in order to avoid default, thereby explicitly yielding Westphalian sovereignty (Krasner, 1999) to non-EU institutions, was the implicit stick. Market discipline was the operating mechanism that made implicit conditionality effective.

The article does not aim to explain Italy's structural reforms and their outcomes. Its goal is a more modest one: to highlight the power of implicit conditionality as a source of EU involvement in domestic matters, and cast light on the way in which it operates. This article testifies to a quantum leap in EU's involvement in policy-making of eurozone members: even without formally prescribing this through MoUs, intervention of EU officers in domestic policymaking escalated to a degree of pervasiveness previously unimaginable. Although the bearing of this for democratic processes at the national level is not a concern addressed here, developments described in this article seem to support a revitalization of the fusion hypothesis between EU and member states (Wessels and Rometsch, 1996a) – at least in the eurozone.

The article is structured as follows. The next section defines the concept of implicit conditionality and renders it applicable to the analysis of Italy's sovereign debt crisis. The subsequent section provides an account of the crisis, laying bare the mechanisms at the core of implicit conditionality in the Italian case. The penultimate section traces the process of adoption of structural reforms in pensions and labour policy by the Monti government. The final section concludes, taking stock of the evidence.

Implicit Conditionality and Its Features

Conditionality can tentatively be defined as the granting of some good by a party (or a coordinated group of parties) to a second party that deems such a good valuable, linked to the latter party's compliance with some behaviour valued by the former party. This definition comprises the various forms of conditionality that can be empirically observed, such as *ex ante* or *ex post*, financial, macroeconomic or structural, private or official, membership, cross-based and so forth.[1] It accommodates various types of goods and envisaged behaviour, as well as sanctions for non- or partial compliance and reinforcement by punishment, support or reward (Schimmelfenning and Sedelmeier, 2004).

In all its forms, even when it is framed in terms of 'ownership' (Khan and Sharma, 2003), or what Dyson (2006) calls the 'good servant' narrative, conditionality implies an underlying asymmetry of power. In other words, the stakes for the receiving party are higher than for the granting party, although the latter must of course have an interest in the behaviour of the former, otherwise the overall arrangement would have no raison d'être.

Irrespective of definitional issues, conditionality has been widely analysed in macro-comparative politics in two different realms: the provision of financial aid by the International Financial Institutions (IFIs) such as the IMF and the World Bank, and EU accession for central and eastern European countries (CEEC). With the eurozone crisis, the former type of conditionality, that is, 'the placement of policy conditions on the disbursement of financial resources to national governments' (Babb and Carruthers, 2008, p. 15) has been adopted for some eurozone members, most notably Ireland, Greece and Portugal.

Although instances of conditionality are usually embodied in formalized agreements, and their terms – including the sanctions for non-compliance – explicitly specified through detailed covenants, this article argues that this is not necessary for conditionality to be operational and effective in influencing a party's behaviour. Conditionality can be based on an implicit understanding between the two parties involved that a particular behaviour is expected in order for the good to be made available, even in the absence of detailed covenants. This will be called *implicit conditionality*, and its operational capacity will be illustrated through detailed process tracing of Italy's structural reforms in the sovereign debt crisis.

Comparative politics and political economy literature does not provide much help to 'seize the object' (Sartori, 1984, p. 26) of implicit conditionality. In one of the very few mentions received by the concept, it 'refers to the requirement by private investors and lenders that recipient nations follow certain kinds of policies in order to be deemed "credit-worthy". Such requirements are rarely laid out in the explicit form assumed by agreements with the IFIs' (Griffith-Jones and Stellings, 1995, p. 169). In the empirical reconstruction to follow, implicit conditionality is used by the EU institutions rather than by private parties; however, it will become apparent that

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financial markets play a fundamental role, as market discipline functions as the key operating mechanism for implicit conditionality to be effective.

Although they offer no guidance on implicit conditionality *per se*, discussions of EU conditionality in enlargement to the CEEC provide insight by their treatment of neighbouring concepts. Hughes *et al* (2004, p. 526) distinguish between formal conditionality, 'which embodies the publicly stated preconditions as set out in the broad principles of the Copenhagen criteria and the legal framework of the acquis', and informal conditionality, 'which includes the operational pressures and recommendations applied by actors within the Commission to achieve particular outcomes during interactions with their CEEC counterparts'. Moreover, they argue that the 'concept of conditionality should be seen less as a generic tool for applying pressures for rule adoption […] and more as a process which involves a tool bag of shifting prescriptive norms, and a variety of institutional formats' (p. 547). Although – as will be seen in the empirical analysis – the deployment of implicit conditionality resonates with their concept of informal conditionality, the latter is embedded in a formalized, explicit assertion of the terms of the covenant. A distinction between formal and informal conditionality is also made by Dyson (2006), although with a different meaning: analysing enlargement of the eurozone, he argues that the request to comply with the acquis, in particular on central bank independence and convergence to Maastricht criteria (formal conditionality) is 'reinforced by a tightly defined informal conditionality' (p. 13) that 'functions at the deeper ideational level of background policy paradigms' and 'takes the form of two complementary sets of policy beliefs': the optimal currency area theory and the sound money and finance paradigm (pp. 19–20). Again, informal conditionality is rooted in formalized, explicit arrangements. However, the meaning attached to it by Dyson helps us understand the type of behaviour requested from Italy: structural reforms, particularly labour market liberalizations, as functional equivalents to the missing preconditions of the Economic and Monetary Union (EMU) as an optimal currency area (Hemerijck, 2014).

Finally, the concept of soft conditionality has been introduced in the literature on IFIs' conditional aid: according to Caraway *et al* (2012, p. 42), soft conditions 'refer to policy steps that the IMF would like to see but that have no explicit conditionality attached to them'. They are written in the letters of intent (the MoUs) but 'are not included in the loan contract'.[2] Soft conditions 'contained in the letters of intent can be ignored with few, if any, consequences' (p. 50). Whereas conditions explicitly mentioned in the loan contract entail sanctions for non-compliance, soft conditionality does not. Conversely, in the case that follows, implicit conditionality does entail implicit, but harsh, sanctions. These include the withdrawal of financial support – through sovereign bond purchases – to face severe and, at some points, almost unsustainable market conditions, with the implication of being forced to agree to explicit conditionality, entering a (presumably more constraining and certainly more humiliating) financial aid programme. Thus the envisaged sanction is the denial of further support, so that the conditioned party (Italy) would have to formally

relinquish sovereignty, or default on its sovereign debt. Structural asymmetry of power is pervasive: while the conditioning party (the EU) certainly had a deep-seated interest in helping Italy regain market's confidence, as its default could have entailed the wreck of the eurozone with dire consequences for all, Italy would have lost its access to markets altogether.

While in-depth case analysis shows that implicit conditionality can be consequential and effective, this is not meant to deny that it may suffer from compliance problems as compared to formalized, explicit conditionality. In a situation where determinacy of conditions (Schimmelfenning and Sedelmeier, 2004) is low, however, certainty of incentives and sanctions (Grabbe, 2006) can be enhanced by monitoring (Kahn-Nisser, 2013). The role of EU monitoring to ensure Italy's compliance with the prescribed behaviour will be analysed in the next two sections.

At the Roots of Implicit Conditionality: Italy and the Sovereign Debt Crisis

Italy was hit by the financial storm in the summer of 2011, as a consequence of risks of contagion through the European banking system. This was due to the interplay of several exogenous factors, from the EU mismanagement of the second aid package to Greece, to the necessity for Portugal, after Greece and Ireland, to get conditional financial aid in May 2011, to the 'unconvincing' second round of stress tests conducted by the European Banking Association and published in July 2011 (Jones, 2012, p. 89). Institutional reforms in the governance of the EMU failed to reassure the markets (Hodson, 2012), as repeatedly did signals coming from EU summits (Smeets and Zimmermann, 2013). The new European Stability Mechanism (ESM) was established by Treaty in July 2011 with a lending capacity of 500 billion euro, a sum that according to the US Treasury 'would need to be doubled or tripled to provide an effective backstop for the rest of the eurozone' (Geithner, 2014, p. 473).

In all this Italy, with the fourth largest sovereign debt in the world after Japan, the United States and Germany, hovering at 1.9 trillion euro or 1.2 times the GDP in 2011, started to scare the investors. As a matter of fact, more fine-grained considerations would suggest that Italy's gigantic public debt needs not constitute a fundamental threat in a country where net households' wealth was at 8.6 trillion euro in 2011, about 5.4 times the GDP (Bank of Italy, 2012), and considerable primary budget surpluses have been run since 1991 with the sole exception of 2009 (−0.7 per cent despite a GDP plunge of 5.5 per cent) and 2010 (an immaterial −0.1 per cent). But when fears of contagion rose, structurally low growth even before the Great Recession (with real GDP growth rate at 1.3 per cent per year on average between 1995 and 2008) and policy stalemate (with the Berlusconi government incapable of making tough decisions due to internal cabinet rifts and a divided majority) did nothing but contribute to the flee from Italy's sovereign debt.

In July 2011, the heads of state and government of the eurozone eventually agreed on a second aid package to Greece, while emphasizing private sector involvement. Despite their reassurances that this was due to the fact that 'Greece requires an exceptional and unique solution' (Council, 2011a), fears of contagion exploded. Some days later, the *Financial Times* disclosed that Germany's biggest lender, Deutsche Bank, had reduced its net exposure to Italy's debt by a stunning 88 per cent in the first six months of the year, from 8 billion to less than 1 (Milne and Wilson, 2011). From April to early July Italian credit default swaps had tripled, and the yield differential between 10-year Italian and German government bonds, which had been lower than 200 basis points since the introduction of the Euro in 1999, reached 400 basis points at the beginning of August. This occurred only a month after the June European Council had endorsed a budget-correction package aimed at reaching a balanced budget in 2014, then passed in parliament in mid-July.

Italian sovereign debt became a matter of immediate concern for the survival of the eurozone. On 4 August 2011, the ECB governing council decided to resume purchases of sovereign debt paper on the secondary market – the Securities Markets Programme (SMP) launched in May 2010 – to ease tensions on the financial markets. This decision was however taken by majority vote, as German, Dutch and Luxembourg members of the council voted against any resumption of the programme. Purchases started while the ECB President, Trichet, was briefing the press, but much to everyone's surprise they only involved Irish and Portuguese bonds, thus adding even more pressure on the Italian bonds. In the same press conference, Trichet repeatedly emphasized the role of structural reforms, in particular 'the removal of labour market rigidities' (ECB, 2011a).

The following day, a confidential letter was sent to the Italian government, signed by Trichet and the president-elect of the ECB, Draghi, at the time still the governor of the Bank of Italy. Later in the day, the Italian government announced that it would hasten the achievement of a balanced budget by one year, to 2013. A new meeting of the ECB governing council was called two days later (on a Sunday), after which the ECB issued a statement where it announced it would now 'actively implement its Securities Market Programme' (ECB, 2011b). Between 8 and 12 August the ECB purchased on the secondary market sovereign paper for 22 billion euro (ECB, 2011c).[3]

To bring forward a balanced budget from 2014 to 2013 was a request set out in the letter from the ECB, alongside incisive specific measures regarding growth, competition and liberalizations. Among these, 'a thorough review of the rules regulating the hiring and dismissal of employees should be adopted in conjunction with the establishment of an unemployment insurance system and a set of active labour market policies'.[4] Moreover, the letter asked the Italian government to 'intervene further in the pension system, making more stringent the eligibility criteria for seniority pensions and rapidly aligning the retirement age of women in the private sector to that established for public employees' (already harmonized with the male age following a decision of the European Court of Justice).

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The letter sent by Trichet and Draghi never mentioned the SMP. Still, the sequence of events is rather eloquent. Although not explicitly embedded in a formalized conditional aid programme, the letter imposed a policy agenda on the Italian government, going as far as to indicate the specific actions to be implemented, the policy alternatives to be selected (Kingdon, 1984). Moreover, it clearly specified the regulatory instrument to implement such actions, requiring the Italian government to resort to an urgent decree, to be ratified by parliament in September.

In short, while acting to ease the pressure on the Italian bonds by making purchases on the secondary market, the ECB imposed certain conditions that, despite not being formalized in MoUs, were nonetheless stringent and pervasive, as the ECB was setting the policy agenda, alternatives and instruments to be adopted in exchange for its support.

An emergency package was introduced by decree in mid-August and approved by parliament in September, as per the ECB's request. It aimed at reaching a balanced budget in 2013 through austerity measures worth 45.5 billion euro overall (20 billion euro in 2012 and 25.5 billion euro the following year, to be realized mostly after the general elections envisaged in 2013). It brought about bits of retrenchment in pensions, adding to the ones already implemented in the two previous years. What the government could not agree upon was a thorough reform of seniority pensions, mainly due to the opposition of the Northern League (the bulk of seniority pensions going to workers in the manufacturing North). As for the reform of individual dismissals, an issue that despite various attempts had proved intractable for the Berlusconi governments since the early 2000s, a provision was passed that allows for collective agreements at the plant or local level to derogate from national collective agreements and also from the law in various areas, including employment protection, paving the way for plant-level concessions against the will of the unions at the national level.[5]

Skewed towards savings to be realized in the future, the August policy package failed to convince the international investors. In the last days of August, the yield differential with the Spanish bonds became positive. Under attack on the financial markets, Italy became 'the most important focus for concern in the eurozone' (Jones, 2012, p. 93).

At the European Council of 22–23 October 2011 the EU institutions insistently asked Italy to make further efforts in implementing structural reforms. Berlusconi promised new reforms, but those promises met with scepticism from other EU governments and institutions.[6] An informal summit of the European Council members was then called on 26 October 2011. In the days between the two meetings, Berlusconi desperately tried to convince the Northern League of the necessity to reform seniority pensions, but to no avail. Then, with the international reputation of the Italian government irremediably compromised, he sent a letter to the presidents of the European Council and of the European Commission (EC) announcing a set of reforms, to be better specified by 15 November. In particular, the Italian government committed itself to approving, by May 2012, a 'reform of labour legislation […] functional to a

greater propensity to hiring and to the companies' need for efficiency also through new regulations concerning dismissal for economic reasons in open-ended labour contracts' (Berlusconi, 2011, own translation). As for pensions, Berlusconi could do nothing more than mention Italy's success in reforming its pension system and in making it financially sustainable, increasing the retirement age for old-age pensions to a threshold higher than that of many of its European partners. The government committed itself to setting the statutory retirement age at 67 for all citizens (both men and women, in both the public and private sector) by 2026, but it did not mention any new actions concerning seniority pensions in addition to the measures already adopted.

Worried by what sounded like a plan about future plans, in an unprecedented step with a country that had not signed any MoU, the heads of state and government of the eurozone entrusted the EC with the task of providing 'a detailed assessment of all the measures and monitoring their implementation', inviting 'the Italian authorities to provide in a timely way all the information necessary for such an assessment' (Council, 2011b). Then, the EC – in the person of the Commissioner for Economic and Monetary Affairs, Rehn – pushed again for a quicker transition for women employed in the private sector as well as the abolition of seniority pensions and asked for clarifications on Italy's commitment to reform the labour market (as well as on several other aspects of Berlusconi's letter). This was done in a letter sent to the Italian Treasury Minister, Tremonti, on 4 November 2011, making no less than 39 detailed remarks on which it elicited a response within a week.

Monitoring of the implementation of announced reforms would also come from the IMF. At the G-20 summit in Cannes, on 3–4 November, Italy was offered to enter an IMF precautionary credit line worth 85 billion euro. Despite forceful pressures to sign up, the Italian government refused, accepting however IMF surveillance without financial aid, so as not to enter a formal conditional lending programme.

On this backdrop, with Italy haunted by outright lack of credibility, the only lifeline could come from ECB purchases. However, at the beginning of November, members of the ECB governing council discussed (and disclosed) the possibility of stopping the purchase of Italian paper if the Italian government failed to implement the promised reforms.[7]

At the end of October, a bond auction was covered less than 1.3 times, at yields above 6 per cent that was previously considered the redline before serious default risks. In just a handful of days, the yield spread between 10-year Italian and German government bonds increased by 150 basis points. It reached 553 basis points on 9 November when a major clearing house announced it would increase the cost of using Italian paper as collateral (Jones, 2012). Two days later, after the budget law for 2012 was passed in parliament, Berlusconi resigned, followed by a technocratic government formed under the aegis of the President of the Republic Napolitano and led by the former EU Commissioner Monti. The three main parties in parliament supported the Monti government: the centre-left Democratic Party, the centrist Union of the Center and the centre-right People of Freedom, Berlusconi's own party.

The Monti Government and Its Structural Reforms

The government led by Monti quickly adopted the ECB letter – and the structural reforms it prescribed – as its roadmap. The government identified pension and labour policy as the stage where to show commitment to reform and acquire reputation by successfully tackling issues that had daunted the previous governments. It also did nothing to conceal blatant distaste for the trade unions, perceived and portrayed as forces for the preservation of the status quo and partly responsible for the country's dramatic situation. This also meant the introduction of reforms that would deeply affect categories of workers ('insiders') largely untouched by previous reforms.

Actually in his keynote speech to the Italian Senate on 17 November 2011, asking for the parliament's confidence, Monti had sounded much more cautious, and keener on accepting compromise than what would then be the case. About the labour market reform, he stated that it would be introduced 'with the agreement of the social partners' and, most notably, 'the new system to be designed shall be applied to new labour relationships […], while already existing regular and stable labour relationships shall not be modified', words to be later contradicted by the actual realization of the reform. As for pensions, he praised the reforms introduced over the previous two decades, 'which have led the Italian pension system to be among the most sustainable in Europe'. However, he then framed the issue in terms of inter-generational and horizontal equality, so as to pave the way to a new reform: 'Yet, our pension system remains characterized by wide disparities in treatment across different generations and categories of workers, as well as by unjustified privileged areas' (Monti, 2011, own translation).

The pension issue was tackled immediately, also to secure financial savings. A reform was introduced in December 2011 within a budget package that included an array of interventions worth 30 billion euro, 3 per cent of the GDP, made of 13 billion euro in cuts and 17 billion euro in new taxes. The reform implemented with immediate effect some of the measures adopted by the previous Berlusconi government in its summer packages, in particular a system for automatic retirement age increase based on increased life expectancy, entailing a projected minimum retiring age of 67 by 2019 irrespective of gender, locked in by 2021 irrespective of any more favourable demographic trend. The retirement age for women employed in the private sector was rapidly equalized to that of the other categories. Further measures were introduced, but the most incisive changes concerned seniority pensions, which were abolished and replaced by early-drawn pensions, following new conditions that were made more stringent with immediate effect. Overall savings were estimated in 0.2 per cent of the GDP in 2012, 0.9 per cent in 2015 and 1.4 per cent in 2020 (Jessoula, 2012).

The Monti government implemented the pension reform unilaterally, without negotiating with the social partners but merely informing them of the decisions taken. Negotiations with the social partners took place instead on the labour market reform, starting in January 2012. The planned reforms were mainly aimed at two policy

goals, both stemming from the ECB letter.[8] The first was to reduce segmentation in the Italian labour market through the (mainly re-)regulation of non-standard contracts on the one hand, and on the other the (de-)regulation of individual dismissals of open-ended workers, especially of economic dismissal (that is, for economic motives). The second was to reform income support for the unemployed, an issue mentioned by the ECB letter, that the Berlusconi government had chosen to ignore completely, but on which both the eurozone leaders and Commissioner Rehn had insisted.

The contentious issue was obviously that of the regulation of economic dismissal. This quickly became the focus of attention of financial media and analysts, as well as of European institutions and international economic organizations in their monitoring of Italy's reforms. Monti was determined to get fast approval of a reform that had become the litmus test for the capacity of the government to deliver. The commitment made by Berlusconi in his letter to introduce a reform by May 2012 was written on the wall. In February, the Spanish government led by Rajoy had approved an important labour reform, reducing protection for open-ended workers and making economic dismissal easier (Berton *et al*, 2012). This was making Italy look behind the curve in the implementation of structural reforms, all the more so after a bill to liberalize services and professions (another request from the ECB letter) had been watered down by parliament after pressure from economic lobbies (Mattina, 2013). Relief of tensions on Italian debt as a consequence of Long-Term Refinancing Operations performed by the ECB in December 2011 and February 2012 was taking urgency away and risked delaying the reform process.

Therefore, in a meeting between the government and the social partners in late March, Monti – who had not previously participated in the negotiations – decided to push the unions to the wall. He asked them to agree on a proposal he made that no longer envisaged reinstatement in their job for workers whose dismissal for economic motives was later declared illegitimate by a judge. Only monetary compensation was envisaged, determined by the judge within a predefined range.[9] Monti was about to leave for the Far East, to meet potential investors in Italian debt securities at a road show in China, which was seen as a crucial opportunity for Italy's financial viability.

All the social partners, except the left-wing trade union *Confederazione Generale Italiana del Lavoro* (CGIL), agreed to the government's reform proposal, which included also interventions in the field on non-standard work and an overhaul of the unemployment benefit system. However, the opposition of the CGIL created serious problems to the Democratic Party, where the wrench made by the Prime Minister risked causing an internal rift, with unpredictable repercussions on the support given to the government. Indeed, the reform was being opposed not only by the CGIL but also by the rank and file of the other trade unions, which at the local and plant level sided with the CGIL despite the stance taken by their national representatives.

The EU, for its part, sided with Monti and warned him not to retreat. In a confidential note on Italy's financial situation prepared for a Eurogroup meeting in

late March, the EC (or rather, its Economic and Financial Affairs Directorate) gave a positive assessment of the reform, urging the government not to water it down:

> The Commission has been closely following the debate between the government and the social partners on the content of labour market reform … . The momentum of reform must be maintained. The responsibility for a quick adoption of an effective reform now rests with the parliament. While it is very positive that the draft reform proposal by the government builds on a constructive dialogue with the social partners, it is crucial that the objective and degree of ambition of the reform remain commensurate to the challenges of the Italian labour market, in line with the Council recommendation.[10]

The government itself, however, was not all of one mind about the matter at hand. At the same time, the CGIL showed its willingness to reach a reasonable agreement that could allow it to bring home some bacon, thus eroding support for the hardline internal opponents of its reformist leadership. A compromise was brokered by the leaders of the three coalition parties, and Monti had to swallow it. It gave judges power to order the reinstatement of workers in case of proven 'manifest non-existence' of the alleged grounds for economic dismissal, as an exception to the general rule of monetary compensation and no reinstatement.

The reform bill introduced to the Senate in early April was acceptable to all parties involved. All the political forces, as well as the trade unions, knew that the discussion in parliament could lead to some changes being made with regard to other issues, but the compromise reached on individual dismissal regulations could not be challenged. All the actors were aware of the fact that, by showing acceptance of the agreement, a clear message was being sent to the European institutions, the other member states, international economic organizations and the markets. The development of parliamentary work was constantly and closely monitored by EU institutions and international economic organizations, which had regular contacts with the decision-makers involved. After being approved under a motion of confidence in the Senate at the end of May 2012, thus showing that the commitment made by the Berlusconi government was being honoured, the reform bill entered the House. There, for reasons related to domestic politics, its advancement was at risk of delay (Sacchi, forthcoming), despite resumed tensions on the Italian bonds, whose yields surpassed again 6 per cent with a spread against German ones hitting again 400 basis points.

As already seen when Monti left for China, the process of the reform was influenced by another circumstance that he exploited as an external constraint to get the bill approved, that is, the European Council planned for 28–29 June. As a matter of fact, that was a summit of paramount importance for Italy, as the implementation of the ESM was to be discussed. Italy and Spain, backed by France (now with a socialist government), were trying to curb the resolute opposition of Germany to accept eurozone support facilities to take pressure off the sovereign debt of a member

state through government bond purchases by the ESM (what the media called 'anti-spread shield'). In particular, Monti insisted that such facilities could be accorded on grounds of fulfilling standard conditions written in the EU budgetary and economic surveillance rules, with no stricter conditionality and without any involvement of the IMF in the drawing up of the MoU. In order to secure this outcome, which Monti considered vital to preempt speculative attacks against Italy, his government had to show that homework had duly been done, and commitments made had been honoured, hence the urge to get the labour market reform passed by the House before the summit. This occurred on 27 June. The law was signed by the President of the Republic the next day, with the approval of the EU, international economic organizations and rating agencies.

Conclusions

EU involvement in member state policymaking has clearly escalated as a consequence of the eurozone crisis, after recognition of interdependencies within the EMU. Changes in EMU governance, from the introduction of the European Semester to the adoption of new treaties such as the Fiscal Compact to buttress the diptych 'sound money and finance' paradigm and 'optimal currency area' theory (including their most immediate consequence: the ubiquitous cry for structural reforms) testify to this development. De la Porte and Heins (forthcoming) identify three dimensions of such renewed involvement: objectives, or policy aims, which refer to 'how precisely and with which magnitude policy change is suggested' (p. XX); surveillance of national policy by EU actors; and, finally, enforcement, which refers 'to the type of measures EU actors have at their disposal to ensure implementation and/or corrective action in the case of non-compliance' (p. XXX).

In terms of objectives, it seems fair to say that the abolition of seniority pensions can be deemed a relevant departure from Italy's policy legacy, although not completely path-breaking. What is certainly path-breaking is the new discipline of individual dismissal, with the removal, if not in very particular cases, of reintegration of the unfairly dismissed workers in their previous job even in large firms. Another important bit of the labour market reform involves the reform of unemployment benefits that, contrary to the usual European trend, extends coverage and increases protection (Sacchi, 2013). As seen, although mentioned in the ECB letter, this issue had been obstinately dodged – for financial concerns, but also for its policy beliefs (ibid.) – by the Berlusconi government, despite EU's insistence on it.

Where EU involvement in domestic politics and policymaking really looms up, however, is on the surveillance dimension. EU institutions carried out frequent and pervasive monitoring of Italy's commitment to the agreed structural reforms, from

adoption to implementation. Policy prescriptions that would then constitute the roadmap of Monti's government had long been advocated for by EU institutions, particularly as concerned labour market segmentation and a reform of dismissal rules, but not having teeth they had been sidestepped.[11] This time was different, though, as such prescriptions were now written in the ECB letter, the unofficial covenant – as it were – of implicit conditionality. The Council mandates the Commission to monitor the implementation of Berlusconi's commitment, an unprecedented step vis-à-vis a country not under formalized, explicit conditionality. Commissioner Rehn commands the Italian Treasury minister to answer an array of detailed points he fastidiously raises, and to do that within a week. The labour market reform is monitored at every juncture, its contents thoroughly scrutinized, warnings are issued in a way that could easily make defenders of old-school democracy raise an eyebrow, and the parliamentary process is followed day by day.

While monitoring is fundamental in a context marked by low determinacy of implicit conditions, the empirical analysis has clearly highlighted how enforcement crucially hinged on market pressures. Market discipline emerged as the operating mechanism that made implicit conditionality effective. The whole process was driven by Italy's vital necessity to maintain access to markets, with over 400 billion euro of refinancing needs between July 2011 and the end of 2012.[12] This is why benefiting from the Securities Markets Programme was of paramount importance for a country that despite formidable pressures by some of its eurozone partners staunchly refused to relinquish sovereignty to the IMF. The same can be predicated about the extension of the ESM to purchases of sovereign debt without having to undergo 'Troika conditionality' (that is, including the IMF).

This article has shown the importance of implicit conditionality as a source of involvement of the EU in domestic policymaking. The empirical evidence about labour policy reform would seem to point out an extreme case of vertical – and to a large extent also horizontal, across member states – integration of the policy arena, which goes well beyond what is generally meant by Europeanization, and cannot be captured through multilevel governance heuristics. As a matter of fact, the image that could most aptly represent this transformation seems to be that – introduced by Wessels and his associates almost two decades ago – of a fusion 'of national and European institutions in the policy cycle, i.e. the common sharing of responsibilities for the use of state instruments and the increasing influence of the E[U] arena on the vertical and horizontal interaction of national and European institutions' (Wessels and Rometsch, 1996b, p. 328). 'This means for national institutions that they increasingly share responsibilities with other institutional actors outside their own control, be they national actors from other member states or from independent bodies' (Wessels, 1996, p. 36). Whether this will result in any institutional convergence in the foreseeable future does seem a question of some practical relevance for over 300 million eurozone citizens.

Acknowledgements

Financial support from the Collegio Carlo Alberto (project 'Flexicurity Reforms in the EU') is acknowledged, and from the Italian Ministry of Education, University and Research (project 'Economic Crises and Quality of Democracy in Europe'). Elements of this article have been presented in conferences and workshops in Europe, Japan and the United States – thanks to all the participants for their comments. Special thanks to David Natali and Josef Hien. The article was written while holding the Luigi Einaudi Visiting Chair at Cornell University, Cornell Institute for European Studies, whose generous support and warm hospitality I gratefully acknowledge.

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Notes

1 See Babb and Carruthers (2008) for a review.
2 Caraway *et al* (2012) show the relevance of looking also at the actual content of 'loan contracts', rather than only at MoUs.
3 At the end of 2012, the ECB held Italian government bonds worth 102.8 billion euro, out of a total of 218 billion euro of bonds purchased between 2010 and 2012 through the programme (ECB, 2013).
4 The letter was leaked to the Italian daily *Corriere della Sera*, where it was published in late September (see Draghi and Trichet, 2011). All quotations from there.
5 The decree disregarded completely the issue of income protection in case of unemployment, mentioned in the ECB letter.
6 At the end of the summit, the President of France Sarkozy and the Chancellor of Germany Merkel made clear that they did not trust Berlusconi to keep his word. The President of the European Council, Van Rompuy, declared that he had asked the Italian government for reassurance that the measures announced would actually be enacted.
7 In an interview to the Italian daily *La Stampa*, ECB governing council member Yves Mersch said, 'If we observe that our interventions are undermined by the lack of effort on the part of national governments, we have to pose ourselves the problem of incentives', and replying to the interviewer's question if this meant that ECB would stop purchasing Italian bonds if the government failed to implement promised reforms, he stated, 'If the ECB governing council reaches the conclusion that the conditions that led it to take a decision are no longer there, it is free to change such decision at any time. We discuss this all the time' (Mastrobuoni, 2011, own translation).

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8 For a reconstruction of the decision-making process and a discussion of the main contents of the reform, see Sacchi (forthcoming).
9 It is to be recalled that there is no severance payment in Italy.
10 Cited in Spiegel (2012).
11 See, for instance, the 2011 country-specific recommendations issued in the context of the European Semester just a few weeks before the ECB letter (Council, 2011c).
12 Source: Bloomberg.

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