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Circumventing constraints by interalizing Troika oversight? Italy and the Euro crisis negotiations

Leonardo Morlino and Cecilia Sottilotta

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Leonardo Morlino
Cecilia Sottilotta

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Abstract

With the notable exception of Malta, South European countries were severely hit by the Euro crisis. In the extant literature, Southern Europe is often presented as a relatively homogeneous group of debt-ridden countries with converging preferences on the terms of future integration steps. Nonetheless, at a closer look, the ways in which South European countries adjusted to external constraints during the 2010-2013 negotiations diverged substantially. Greece, Portugal, Cyprus and (although in an attenuated form) Spain were all subject to direct oversight by the European Commission, the ECB and the IMF (the so-called 'Troika'), while Italy, in spite of its gargantuan public debt, managed to avoid that. Starting from a discussion of the negotiated responses to the Euro crisis and of South European countries' stances vis-à-vis a number of contested issues emerged during the negotiations, this paper engages with LI theory to suggest that at the height of the Euro crisis Italy managed to avoid external Troika oversight by internalizing it.

1. Introduction

The economic and financial crisis started in 2008 is often described as a "critical juncture" in the history of European integration (Braun 2013; Heinrich and Kutter 2013; Morlino and Raniolo 2017), as relevant reforms to the architecture of the economic and monetary union bound to have long- term consequences were negotiated in a relatively short time span. Accounts of the Euro crisis negotiations based on Liberal intergovernmentalism (LI) seem to provide satisfactory explanations for the outcomes of the Euro crisis negotiations, highlighting their substantial congruence with the preferences of 'core' countries spearheaded

by Germany. Engaging with LI, this article aims to explore Italy's positions during the 2010-2013 negotiations, focusing in particular on the reform of the Stability and Growth Pact (SGP), that is the set of rules introduced in 1997 to underpin the stability of the European Economic and Monetary Union (EMU). The central argument of the paper is that rather than being motivated by pro-europeanism Italy's position can be chalked up to the primary objective of strategically avoiding structural adjustment under Troika oversight. Section 2 provides an overview of the reforms to EMU governance introduced in the wake of the financial-turned-sovereign debt crisis. Based on primary data, namely interviews with former decision makers and negotiators, Section 3 discusses the representation of Southern Europe as a relatively homogeneous bloc of debt-ridden countries whose domestic preferences mostly converged toward terms of integration based on mutualized adjustment costs (Hall 2012; Schild 2013; Schimmelfennig 2015). Section 4 seeks to single out and explain the peculiarities of the Italian case. Section 5 concludes.

2. Negotiated responses to the Euro crisis

In September 2008, US financial behemoth Lehman Brothers collapsed, with the ensuing credit crunch marking the start of a financial crisis which soon reached Europe. By the end of 2010, what had started as a quintessentially financial crisis had turned into a full-fledged sovereign debt crisis. Fear of contagion started to spread in October 2009 after Greek socialist finance minister Papacostantinou disclosed that the country's deficit in that year would soar to 12.5% of GDP, a much higher figure compared to that originally estimated by the former conservative government (Barber 2009). In May 2010 Greece lost access to capital market. A Greek Loan Facility (GLF) was then initially created but it became soon clear that a broader approach to the problem was needed. Two lending facilities were then established to support Euro area countries experiencing fiscal difficulties: a European Financial Stabilisation Mechanism (EFSM) was created in May 2010 and placed under the control of the European Commission, with a relatively small lending capacity (60 billion euros), and the European Financial Stability Facility (EFSF) was set up in June 2010 as a temporary "special purpose vehicle" managed by the European Investment Bank, with a lending capacity of 440 billion euros supplemented with a 250 billion euros commitment by the International Monetary Fund (IMF). Nonetheless, as the spread between Germany's 10-year government bonds interest rate and those of Greece, Ireland, Italy, Portugal and Spain kept soaring, it became apparent that

the EFSF and EFSM also due to their temporary nature were far from being a panacea to financial turbulence in the Euro area (Sibert 2010:4). In July 2011, the need for a permanent financial assistance mechanism thus pushed the Euro area member states to sign an intergovernmental treaty establishing the European Stability Mechanism (ESM). The lending capacity of the ESM was set at 500 billion euros and its payments –crucially subject to conditionality – are meant to operate as a "liquidity bridge" (Kapp 2014) to support countries until they reacquire capital market access.
It should be noted that in order to address the shortcomings of the institutional framework underpinning the process of financial integration within the EU (Jones 2015), after the introduction of the ESM further steps were also taken toward the creation of a European banking union. More specifically, the second half of 2012 was characterized by intense discussion on how to complete the EMU by introducing a common system governing the regulation, supervision, and resolution of financial intermediaries (Howarth and Quaglia 2013).

Parallel to the negotiation of financial support schemes, important fiscal integration steps were taken by EU member states. As well known, in the framework of the SGP, member states wishing to join the monetary union committed to a path of convergence entailing a 3% of GDP limit for budget deficit and a 60% of GDP government debt. Failure to comply with these requirements triggered the excessive deficit procedure which could eventually lead to the imposition of sanctions. Since its inception, the SGP had lacked effective enforcement mechanisms, apart from "peer pressure", "moral suasion" and a no bail out clause which was generally deemed an adequate disincentive to discourage fiscally irresponsible behaviors (Larch et al 2010). In fact, the enforceability of the SGP was further called into question when, after exceeding the 3% deficit threshold, Germany and France banded together to vote down a Commission recommendation aimed at imposing sanctions against them under the excessive deficit procedure (Ngai 2012, 18). In 2005, the Commission promoted a reform of the SGP aimed at directly involving countries in the definition of their own fiscal policy's medium-term objectives, which ended up introducing further discretion and political leeway in the procedures (Schuknecht et al. 2011: 11). Reflecting a view to some extent inconsistently, yet widely held among 'solvent' countries which ascribed the onset of the crisis to lax fiscal discipline, emphasis was then placed on strengthening both the preemptive and the corrective arm of the SGP. The first set of measures entered into force on 13 December 2011 was the so-called Six Pack, consisting of five regulations and one directive

meant to address public deficits and macroeconomic imbalances by reinforcing economic and fiscal surveillance in the EU. One of the capstones of the renewed EMU institutional architecture is the introduction of reverse qualified majority voting (rQMV) for the imposition of fines to non-compliant member states. This represents indeed a U-turn vis-à-vis the 2005 reform of the SGP, as rQMV in fact substantially reduces the political leeway previously characterizing the enforcement of the excessive deficit procedure: once the Commission issues a recommendation to the Council in this sense, the imposition of sanctions against a member state falling short of its medium-term budgetary objectives is automatic unless a qualified majority of member states opposes it. The Six Pack also introduced a "European Semester", a comprehensive framework for the coordination and monitoring of fiscal policies across member states with standardized deadlines throughout the year. On 9 December 2011, while taking stock of the new rules contained in the Six Pack, the European Council declared that not all the necessary measures could be introduced via secondary law. More specifically, some member states were reluctant to introduce further solidarity measures in absence of a parallel increase in common, credible constraints on national expenditure (Mortensen 2013:14). At the same time, as the UK had overtly rejected the hypothesis of incorporating them into the EU treaties (Spiegel et al 2011), the only viable solution left was the conclusion of an international agreement to be signed by March 2012 (European Council 2011). Hence the negotiation of the Treaty on Stability, Co-ordination and Governance in the Economic and Monetary Union (TSCG), also known as the "Fiscal Compact", which was adopted on 2 March 2012 and entered into force on 1 January 2013. Among the other things, the signatories of the TSCG committed to enshrine a "debt-brake" rule into their own constitutions, following the analogous principle – the so- called Schuldenbremse – already introduced into the German constitution in 2009. The signatories also accepted to be subject to the jurisdiction of the EU Court of Justice which oversees the transposition of such rule at the national level. Moreover, as explicitly stated in the preamble to the TSCG, the granting of financial assistance under the umbrella of the ESM is conditional to the ratification of the TSCG itself. The provisions of the TSCG were complemented with the "Two Pack" regulations which entered into force on 30 March 2013. This reform package reinforced coordination and transparency in budgetary policies, and introduced stricter surveillance mechanisms for euro area members, especially those experiencing financial difficulties. In the new framework, the Commission examines and issues an opinion on the draft budget for the following year that each euro area country must submit every year by October 15. In case of patent misalignment of a member state's budgetary plan vis-à-vis the obligations deriving from the SGP, the

Commission can ask the member state to revise the plan and resubmit it.

In light of the rapid unfolding of the crisis and of the limited amount of financial resources available to the EU, it is not surprising that in general the member states' governments played a central role even after the activation of EU mechanisms. In this sense, LI seems to provide a suitable explanatory framework for the outcome of the Euro crisis negotiations. The main theoretical tenets of LI can be summarized as follows. Major breakthroughs in European integration are explained in terms of three elements, that is the (domestic) formation of economic interests, international-level bargaining whose outcome is influenced by the relative power of the participants, and the subsequent institutionalization of "credible commitments" (Moravcsik 1998:4). Adopting this standpoint, the negotiations can be considered as a "two-level game" (Putnam 1988), in which a first phase of interest- formation at the domestic level is ideally followed by a second phase in which political leaders negotiate at the international level trying to accommodate the requests of domestic stakeholders while at the same time containing the negative consequences possibly deriving from the bargaining process. For a negotiation to find a successful outcome, it is essential that a negotiating party's "win-set" – that is a set of measures that can be accepted or backed by domestic constituency – overlaps with the measures agreed upon with other negotiating parties.

LI has been variously criticized e.g. for disregarding the relevance of supranational institutions (Lindberg 1994) and in particular for its inadequacy at accounting for day-to-day governance of the EU (Wincott 1995). However, at a superficial glance the unfolding of the Euro crisis negotiations appears to be congruent with LI's theoretical tenets. In terms of preferences, the perception of the governments of Euro area member states was that the costs of disintegration would be prohibitive and thus measures should be taken to avoid it. Disagreement however started over the distribution of adjustment costs, with national positions mainly aligned with the fiscal position of the member states: according to a LI account, solvent "northern" countries preferred national adjustment, while debt-ridden "southern" countries were inclined towards a mutualization of adjustment costs (Schimmelfennig 2015). The negotiation phase, which has been described as a "war of attrition" (Iversen and Soskice 2013) or a "chicken game" (Schimmelfennig 2015), was characterized by hard bargaining aimed at extorting concessions from reluctant partners, epitomized for instance by Germany's resort to strategic pre-negotiations with France (Héritier 2017) or the Greek government's threat in October 2011 to call a referendum on the second bailout package (Inman and Smith 2011): More specifically, the reformed EMU

institutional architecture was focused on enhanced fiscal discipline with a strengthening of the SGP rules, semi-automatic sanctions for Euro area members falling short of their obligations, and the commitment – contained in the Fiscal Compact—to enshrine a "balanced budget" rule in national constitutions; arguably, the negotiations produced a renewed institutional framework embodying Germany's "ordoliberal" vision of the EMU (Bulmer 2014), whose ultimate aim is to consolidate competitive markets regulated by strong, credible governments (Dullien and Guérot 2012:2), with some of the correctives inspired by the solidarity principle strongly advocated by France, namely the introduction of temporary and permanent financial support schemes (Schild 2013:30) . Even if at first sight, as explained above, LI provides a compelling explanatory framework for the crisis-induced EMU reforms, the research questions addressed in this paper call for a deeper analysis. Following the falsifiability principle embedded in the original formulation of liberal intergovernmentalism (Moravcsik 1998:77), the next sections will shed light on the actual preferences of the actors involved, going beyond journalistic accounts and public declarations of political leaders. First of all, is the liberal intergovernmentalist claim that the preferences of "southern" debt-ridden countries are aligned to their fiscal position underpinned by primary empirical data? If not, what explains divergence? The next sections will show that a) the picture of Southern Europe is more variegated than a superficial analysis would suggest; and b) in the case of Italy, and contrary to what one should expect, an in-depth investigation reveals an apparently puzzling misalignment of this country's negotiating positions vis-à-vis its fiscal predicament.

3. Southern Europe: the unfolding of the crisis

What were the positions taken by South European countries during the 2010-13 SGP reform negotiations? Are they compatible with the claim, put forward by many observers, that due to their similarly problematic fiscal predicament the preferences of these countries essentially converged ? Before addressing these questions, it is first of all useful to quickly recall how the crisis unfolded in each of the countries considered.

As far as **Greece** is concerned, in extreme synthesis the problem was that since joining the monetary union, the Greek government had been in the position to borrow at very low interest rates. This circumstance of course cannot per se be considered as a direct cause for the crisis; however, coupled with a tradition of poor accounting practices, it created the conditions for the 'perfect debt storm' to happen in the second half of 2009, once the financial crisis started

in the US spread to European markets. In this sense, it has been argued that the case of Greece is actually the only crisis genuinely linked to budgetary policy (Stein 2011): it should be recalled that in 2004 Greece had already received a warning by the European Commission for under-reporting budget deficit data (Saragosa 2004). Facing a bankruptcy, the government led by George Papandreou sought and obtained a first bailout worth 110 billion euros in May 2010; a new short-lived cabinet led by Lucas Papademos took over in November 2011 and finalized the negotiation of a second bailout package in February 2012; political instability led to new elections in May and June 2012, resulting in a government led by Antonis Samara which in turn would be replaced by radical left Syriza party leader Alexis Tsipras after the January 2015 elections.

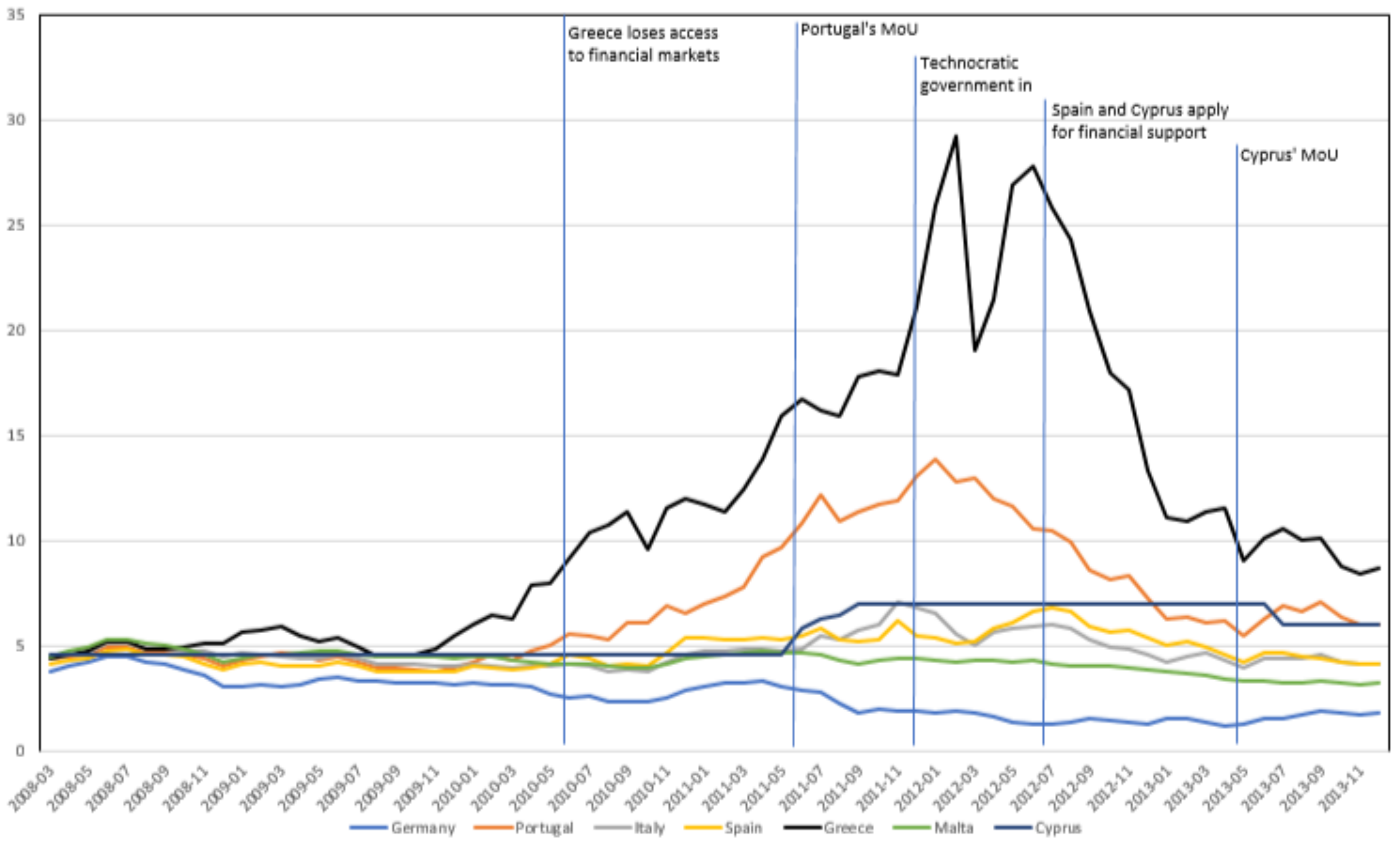
After Greece and Ireland, **Portugal** became the third euro zone country to apply for a bailout. It should be immediately stressed that rather than being ascribable to fiscal profligacy, Portugal's crisis was mostly due to economic stagnation and low productivity in the decade prior to the crisis (Reis 2015:434). In the face of increasing pressure from financial markets, in September 2010 the government led by socialist prime minister José Sócrates announced the introduction of austerity measures, including a freeze on state pensions, cuts in public sector wages and a rise in value added tax (Wise 2010). On March 23, 2011 the Portuguese parliament rejected a further government-sponsored austerity package, a move that triggered the resignation of Sócrates as prime minister and paved the way for a snap election the following June. Amidst political turbulence and after losing access to financial markets, in April 2011 Portugal applied for a bailout. In May a memorandum of understanding (MoU) listing the conditions for disbursement of financial support was signed by the Portuguese government and the European Commission, the European Central Bank and the International Monetary Fund.

Also for **Spain** the enabling conditions for the crisis are not to be directly found in the lack of fiscal discipline. Unlike Greece and Italy, in the years before 2008 Spain did not engage in excessive borrowing, its debt to GDP ratio was well under the Maastricht 60% threshold, and unlike Portugal its GDP growth rate in the five years before the crisis hit was comprised between 3 and 4%, thanks to which the public debt was indeed on a negative trend (World Bank 2015). The distinctive feature of the Spanish case is the construction bubble fed by easy credit, with investment in housing peaking at over 12% of the GDP in 2008 and being reduced to 7% by 2011 (Ortega and Peñalosa 2012), a shock which spread to the rest of the economy through virtually all existing channels: tightening financial conditions slowed down demand for housing, which pushed down house prices and had a negative impact on employment, not

to mention the serious strain faced by the banking sector (especially regional *cajas*) which had to absorb an increasing rate of insolvency of construction firms and found itself left with now almost worthless collateral – real estate property whose value had quickly fallen since the start of the crisis. These circumstances led to the June 2012 decision by the Spanish government led by Mariano Rajoy to accept (up to) 100 billion euros as a 'loan' by the ESM to recapitalize the country's ailing banks.

The situation of **Italy** when the crisis erupted was yet different from that of the other South European countries. For most of its recent history, Italy has been characterized by high public debt; nonetheless, the country has also always had a good reputation in terms of debt management. Moreover – somewhat ironically – the relative isolation and 'backwardness' of the Italian banking sector coupled with effective supervision carried out by the Bank of Italy meant that when the crisis hit, Italy was better equipped than other southern European countries to cope with financial turmoil (Quaglia 2009).

Figure 1. 10 years interest rates (%) on government debt 2008-2013 and relevant events in South European countries


Greece loses access to financial markets
Portugal's MoU
Technocratic government in
Spain and Cyprus apply for financial support
Cyprus' MoU
Germany
Portugal
Italy
Spain
Greece
Malta
Cyprus

Italy's Achilles heel was (and to a large extent still is) to be found in the poor quality of regulation, a business climate that discourages foreign and domestic investment, low labor productivity, corruption, factors which, as the IMF recently put it (Miglierini 2016), account for 'two lost decades' in terms of economic growth in the country. Just as it happened in Greece, the crisis had a relevant political fallout in terms of governmental instability. As fear of contagion – epitomized by skyrocketing 10-years btp yields – soared at the end of 2011[1], the government led by Silvio Berlusconi was replaced by a technocratic cabinet led by former EU commissioner Mario Monti. After the 2013 general elections, the Monti cabinet was in turn replaced by a short-lived 'grand coalition' government led by Enrico Letta , which resigned in February 2014 to be followed by a center-left cabinet led by Matteo Renzi. Among the troubled South European countries, Italy is the only one which managed to avoid any involvement of the Troika, in contrast with Greece, Portugal, Spain and Cyprus which all applied for more or less extensive financial support and therefore signed an official MoU.

While until 2007 the fiscal position of **Cyprus** was quite sound, with a 3.4% surplus and a 58.3% debt-to-GDP ratio bound to be further reduced by the end of 2008 (European Commission 2010a) , by May 2011 the predicament of the country had dramatically changed. The roots of Cyprus' financial difficulties can be found in sluggish growth since the beginning of the financial crisis in 2008 and increases in government spending after the Cypriot Communist party took over in the same year, coupled with the overexposure of the Cypriot banking system to Greek financial institutions. On October 26, 2011 the European Council agreed to "…a significantly higher capital ratio of 9 % of the highest quality capital and after accounting for market valuation of sovereign debt exposures, both as of 30 September 2011, to create a temporary buffer… to be attained by 30 June 2012" (European Council 2011b). A that point, a feedback loop in Cyprus was inevitable: while it was extremely hard for Cypriot banks to raise the required capital, it would be equally difficult if not impossible for the government to bail in the banks. Unwilling to initiate a structural adjustment program under the aegis of the Troika, in the second half of 2011 the Cypriot government bought itself some time by securing a 2.5 billion emergency loan from Russia, but it should be noticed that such loan was meant to offer support for the country's budget deficit and excluded any recapitalization of the country's banking sector (Katsourides 2014:52). In June 2012, after a downgrade of the Cypriot sovereign by all of the "Big three"

[1] As shown in Figure 1, in November 2011, the Italian 10-years government bond yields almost reached 7%, with a spread of over 5% vis-à-vis the German Bund.

credit rating agencies that made the government debt not eligible as collateral for borrowing from the euro system, the government finally asked for assistance for its banking system (The Economist 2013). In the run-up to the February 2013 election, the incumbent communist government claimed that the responsibility for the crisis in Cyprus lay with the banks (Orphanides 2014:22-23), and it was only in March 2013 that the newly elected conservative president agreed to a €10 billion bailout deal including a haircut to bank deposits under the threat that the ECB would stop providing liquidity to the Cypriot banking system (The Economist 2013). A MoU between Cyprus and the Troika was finally signed in April 2013.

Unlike the other five South European countries, **Malta** was virtually untouched by the sovereign debt crisis in the euro zone. In spite of the relevant role played by financial services in the Maltese economy, due to generally good levels of capitalization and relatively low level of external exposure of domestic banks (Azzopardi 2009: 105). Given such background of overall economic stability, it is not surprising that the 2013 Maltese general election, finally resulting in the success of the Labour Party led by Joseph Muscat, was dominated by issues of competence and credibility of the rival parties, in stark contrast with to the other five South European countries which were experiencing economic and financial difficulties (Fenech 2013).

4. Southern Europe: Euro crisis negotiations and contested issues

In order to provide a more nuanced picture of South European countries and their preferences against the backdrop of the Euro crisis this section will a) look at the contested issues emerged during the negotiations and b) actually map the positions of the six South European countries vis-à-vis those issues. This section is based on member states interviews conducted in the framework of the Horizon 2020 EMU choices project and focuses in particular on four contested issues which have spurred debate among the EU member states during the negotiation of the EMU reform packages. The first issue was whether or not to support Greece, and was discussed by the Euro group before the Greek government actually decided to ask for support in May 2010. The Euro group eventually decided to offer support on March 15, 2010 (European Commission 2010). The second issue hinged upon the possibility to endow the ESM with a firepower greater than € 500 billion, a figure that was considered adequate by some (e.g. Germany, Austria, Finland) whereas others would have preferred a

larger size. The third issue arose over the provision, eventually incorporated into the Six Pack, to introduce rQMV that is a semi-automatic mechanism triggering sanctions to punish member states violating the SGP. The fourth issue, emerged during the negotiation of the Fiscal Compact, was whether and how to institutionalize the commitment of member states to budget discipline by incorporating a debt brake into the domestic legal systems. In the first two drafts, reference was made to "national binding provisions of a constitutional or equivalent nature", a vision that embodied the German preference, while the final text included a "softened" version of the original formula, referring to "provisions of binding force and permanent character, preferably constitutional, that are guaranteed to be respected throughout the national budgetary processes" (Kreilinger 2012: 4). As explained above, at first sight liberal intergovernmentalism can certainly be considered as a good theoretical framework to explain the outcome of the 2010-2013 negotiations. For one thing, it is undisputable that the final outcome largely mirrored the preferences of the countries with greater bargaining power – Germany in particular. However, some qualifications are in order when it comes to discussing and explaining the preferences of "South European countries" as generally presented even in authoritative accounts of the crisis (see e.g. Schimmelfennig 2015). First of all, equating "southern" and "debt-ridden" is inaccurate. As noted above, Malta is a clear exception in this sense. Moreover, although it is true that some countries, namely Italy and Greece, have historically been 'debt-ridden', it is equally true that other countries such as Spain and to some extent Cyprus had indeed been quite virtuous from the fiscal viewpoint prior to the crisis and that no matter how fiscally virtuous their governments were, piecemeal approaches to domestic banking crises (sometimes the only option on the table) turned out to be simply too expensive for taxpayers.[2] In this sense, it is plausible to infer that their primary interests – and thus, their future preferences – may not necessarily lie in debt mutualization. Second, as further explained below, the positions of South European countries were far from being completely aligned, especially as far as the third and fourth contested issues considered are concerned (see Table 1 below summarizing the issues and the positions). When it became clear that the situation of Greece was rapidly deteriorating and that the worsening of the crisis through contagion could threaten the very survival of the monetary union, virtually all EU member states, although with partially diverging motivations, agreed that some support had to be offered and that a permanent financial stability facility was needed.

[2] On this point referred to the Spanish case, see Otero-Iglesias et al (2014 :53).

Table 1 Contested issues and South European countries positions

Issues\ countries	Cyprus	Greece	Italy	Malta	Portugal	Spain
Support to Greece (final decision : 15 March 2010)	In favour	In favour	In favour	In favour	In favour	In favour
Increase the size of the ESM (final decision: 29 October 2010)	Strongly in favour	Strongly in favour	Strongly in favour	In favour	In favour	In favour
rQMV as decision making mechanism triggering SGP sanctions (final decision: 16 November 2011)	Contrary	No position	In favour	Initially contrary, then came on board	Contrary	Contrary
Introduction of Schuldenbremse in the constitution (final decision: 2 March 2012)	Lukewarm support	Lukewarm support	In favour	Contrary to constitution al level, accepting binding provisions	Contrary to constitution al level, accepting binding provisions	In favour

This explains convergence with regard to the first two issues. However, moving to the third issue, it is safe to say that the positions of the countries considered were not completely aligned. The perspective to introduce a semi-automatic mechanism for the imposition of sanctions under the SGP, described by most interviewees as a "technical", non-politicized issue, was not met with favor by the Cypriot negotiators. Although at the time Cyprus was not yet experiencing financial difficulties, the government would have preferred to maintain the status quo mainly because the introduction of rQMV would entail a significant loss of sovereignty for such a small country (Cyprus Interview 1, 2 and 3). The same applies to Malta, whose government leaned towards the status quo (Malta Interview 3 and 4). In both Spain and Portugal the issue was not discussed by the parliament and it was eventually decided upon by the respective governments. In Greece, the government reportedly had no position on this specific issue as it was focusing on more urgent problems and ended up by following the consensus that eventually emerged among the other member states (Greece Interview 3 and 5). As for Italy, its position was in favor of semi-automatic sanctions, thus running against the preferences expressed by the other South European countries. It is

possible to notice a discrepancy also with respect to the introduction of a constitutional-level debt brake rule debated during the negotiation of the TSCG. The Greek government, although it clearly found itself in a particularly weak position as it was in need of help (Greece Interview 1 and 2), found two orders of difficulties in supporting a text imposing an amendment of the constitution: while on the legal side there were objective impediments to incorporating the debt brake into the constitution, on the political side there was some resistance against the idea of losing control over fiscal policy-making and (Greece Interview 3 and 5). Ordinary legislation for the debt brake rule was also the preference of Cyprus, while Malta and Portugal shared concerns that it would be technically difficult to incorporate the rule into the constitution, although in principle they did not object to introducing binding provisions on fiscal discipline. When it comes to Italy and Spain, however, the situation is yet different. The governments of both countries speedily agreed to amend their constitution. While in the case of Spain this produced some domestic debate (Spain Interview 1 and 4), in Italy there was virtually no opposition, exception made for two small opposition parties, i.e. the Northern League and Italia dei Valori. The debt brake was incorporated in the constitution in an exceptionally short time,[3] with the last vote taking place on 17 April 2012. Moreover, constitutional law 1/2012 containing the provision was passed swiftly by both chambers of the Parliament with a two thirds majority, which avoided the possibility of a confirmative referendum.

From what said so far, it clearly emerges that the position of Italy seemed to be in stark contrast with its economic interests and to some extent also with the preferences of the other South European countries. How is it possible to explain this puzzle? In order to suggest a response to this question, the next section dwells upon Italy's "choice for Europe since Maastricht".

5. Explaining the Italian difference

According to LI "the preferences of national governments regarding European integration have mainly reflected concrete economic interests rather than other general concerns like security or European ideals" (Moravcsik and Schimmelfennig 2009: 70). Following this line of reasoning, we should expect that a given government's negotiating stance be mainly aligned with domestic conditions, including (but not limited to) economic fundamentals. And

[3] The first draft of the constitutional law had been approved on 30 November 2011 (Il Sole 24 Ore 2012).

yet, Italy's positions during the negotiation of the Six Pack and the TSCG as described above constitute a puzzle, as they clearly defy our reasonable expectations which would point to a preference for more flexibility rather than for stricter pro-austerity rules. How to account for them? A first possible hypothesis hinges on the concept of "vincolo esterno" (Moschella 2017). "Vincolo esterno" or "external constraint" can be defined as the strategic – and distinctive – use of external constraints made by Italian policy makers with the ultimate purpose of triggering domestic change (Vesan 2015: 499). The "vincolo esterno" principle was introduced by prominent policy-maker (and Treasury Minister at the time of the Maastricht Treaty) Guido Carli, who was convinced that only the external conditioning embodied by the European Union could "save Italy from itself" by fixing the country's dysfunctional economic and entrepreneurial system (Berta 2015: 484). A firm belief in the possibility and indeed desirability of "importing" macroeconomic discipline and credibility by joining the EMU – reinforced by the overwhelmingly pro-European attitude of the public opinion – indisputably influenced the orientations of Italian élites during the negotiation of the Maastricht Treaty (Quaglia 2004: 1107-1108). In fact, the articulated policy priorities set by Italy in the intergovernmental conference leading to the Maastricht treaty were on all counts consistent with this doctrine (Dyson & Featherstone 1996: 274). A further argument (borrowed from LI) that could be used to underpin the "vincolo esterno" explanation is that a key mechanism shaping institutional choice is that "…Governments transfer sovereignty to commit other governments to accept policies favored by key domestic constituencies and perhaps also to precommit the government to policies opposed by domestic groups unsupportive of the government" (Moravcsik 1998: 76). Thus, it would be reasonable to hypothesize that the technocratic government[4] led by Mario Monti – himself a pro-EMU economist –supported measures such as the introduction of the rQMV on the imposition of SGP sanctions, the accession to the TSCG and the "constitutionalization" of budget discipline out of the belief that they could facilitate domestic reform. A positive, recent example of how this principle can work in practice is the reform of the banking sector in Spain after the countries signed a MoU; in fact, it was only under the pressure of the Troika, an external actor whose legitimacy ultimately derived from its independence and expertise, that a full-fledged strategy for a truly impartial audit of the financial institutions, the acknowledgment of losses and a restructuration of the whole system eventually took place in a relatively short time (Otero-Iglesias et al 2016: 44).

[4] The Monti cabinet almost perfectly embodied the ideal type of technocratic cabinet entirely made up of technocrats (Brunclík 2015: 59).

Compelling as the “vincolo esterno” explanation would be, however, the results of the interviews conducted lend little support to it. Coherently with the findings of Moschella (2017), who discusses the government’s commitment to external constraints as a possible explanation for Italy’s speedy accession to the TSCG, other factors seem to have been crucial in shaping Italy’s positions. In particular, it should be recalled that at the time of the negotiation of the Six Pack and of the TSCG, Italy was struggling to regain credibility in the eyes of international markets and the EU countries (Italy interviews 0 and 2). Thus, although it would have been plausible to expect Italy to oppose an excessive tightening of the rules, the top priority for the Italian government at the time was to restore credibility, hence the commitment to austerity measures as a way to send a clear message to other EU governments and calm down turbulent financial markets. In several occasions key members of the government, namely Italy’s prime minister Monti and minister for European Affairs Moavero Milanesi, overtly referred to more stringent fiscal discipline as necessary rather than desirable, and they stressed that strategies for growth should also be prioritized in the wake of the crisis (Moschella 2017). Thus, it can be said that fiscal discipline was conceived of as a “bitter pill” that nonetheless had to be swallowed in order to avoid the worst (Italy Interview 0). When updating the parliament on the fiscal compact negotiation, Monti stressed that the Italian government’s priority was to ensure a coherent framework for EU rules and to “avoid the introduction of constraints and stricter limits with respect to those already in force under the SGP and finally to balance the budget rules with mechanisms aiming to relaunch economic growth” (Monti 2011). In fact, “damage control”, that is extricating the country from a critical situation while at the same time containing the impact of external pressures, rather than using them strategically to induce domestic reform, was the primary objective of a government.[5] Mario Monti took office on 16 November 2011, only four days after the resignation of Berlusconi. A key role in his very appointment was played by the head of state Giorgio Napolitano, which took the initiative at a moment when Italy’s political parties were proving incapable of reaching any compromise on the formation of a new cabinet (Giannetti 2013) and after Greece and Portugal, Italy seemed to be the next in line for a default, with the aggravating circumstance that, with no financial support scheme in place yet, Italy appeared to be too big to fail and yet too big to bail (Elliott 2011). According to Marangoni (2012), 27 items classifiable as specific commitments can be singled out analyzing Monti’s inaugural

[5] Significantly, one of the first measures taken by the Monti cabinet was the so-called “Save Italy” Decree, a structural adjustment package worth € 30 billion over three years (The Economist 2011).

speech. Of these, 7 referred to micro and macro economic policies aimed at boosting growth, while the remaining 20 commitments were distributed among the following policy areas: improvement in the public finances, reduction in the costs of maintaining elected bodies, rationalization of the public administration, reform of welfare, fight against tax evasion, taxation of property, selling off of publicly-owned real estate, intervention in the labor market (Marangoni 2012:141). Evidently, the measures envisaged by the new government's roadmap were tantamount to an ambitious program of structural adjustment whose contents and areas of intervention are similar to those included in the Greek and Portuguese MoUs. As Sacchi (2015) points out, in the case of Italy a mechanism of "implicit conditionality" was at play at the height of the sovereign debt crisis. In fact, Monti's government roadmap essentially reflected the contents of a confidential letter signed by Jean-Claude Trichet and Mario Draghi, ECB president and president-elect respectively, and addressed to Italy's then prime minister Silvio Berlusconi on 5 August 2011. In the letter, later leaked to the press (Corriere della Sera 2011), the ECB recommended urgent fiscal corrective measures including cuts in the cost of public employees and interventions in the pension system.[6]. In sum, A *de facto* strict surveillance by European institutions coupled with Italy's vital need to maintain access to capital markets eventually put the Italian political establishment before the choice to either enter a formalized aid program or rather "internalize" oversight maintaining at least officially some autonomy in the implementation of the necessary measures.

6. Conclusion

The sovereign debt crisis constituted a critical juncture for the Eurozone, triggering a number of relevant institutional reforms in the architecture of the EMU. The Six Pack, the Two Pack, the Fiscal Compact, accompanied by the creation of the ESM, strengthened the surveillance and enforcement provisions of the SGP. In the extant literature, Southern Europe has often been presented as a relatively homogeneous group of debt-ridden countries with converging preferences on the terms of integration steps. Nonetheless, at a closer look, the paths leading to the crisis and the ways in which each of the South European countries adjusted to external constraints during the negotiations diverged substantially. If all South European countries were subject to direct oversight by the Troika, a notable exception was Malta, which was

[6] It should be recalled that as of August 2011 the ECB extended its Securities Markets Programme – that is, purchases of sovereign bonds on the secondary market – to Italian and Spanish government bonds (Casiraghi et al 2013).

virtually unaffected by the crisis, and Italy, which experienced financial turmoil but managed to avoid entering a formal rescue scheme. When looking at some major contested issues emerged during the negotiations, it comes to light that the positions held by Italy on matters of fiscal discipline partly differ from those of the other South European countries and – somewhat surprisingly – seem to point to a preference for stricter discipline which is at odds with the country's high level of public debt. The "vincolo esterno" principle, a plausible explanation for this puzzle, can however be dismissed in light of the evidence collected. Instead, the results of the interviews conducted in the framework of the EMU choices Horizon 2020 research project lend further support to the argument put forward by Sacchi (2015) and Moschella (2017), namely that the underlying logic governing Italy's preference formation at the height of the crisis was a strong commitment by domestic decision-makers to avoid formal oversight by the Troika, although a mechanism of implicit conditionality vastly constrained the options available to them. In a nutshell, the Italy's preferences are much more easily explained if they are correctly framed not in terms of a choice between stricter or more lax fiscal discipline but rather in terms of Euro area membership versus exit and possibly a financial Armageddon. From the theoretical point of view, it can also be concluded that LI still retains its explicative power but that the notion of "Southern Europe" needs to be problematized and a more nuanced study of the individual cases is necessary both to explain what happened and to make sounder forecasts about the future.

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