

AperTO - Archivio Istituzionale Open Access dell'Università di Torino

Too big to fail? The dynamics of EU influence and fiscal consolidation in Italy and Spain (2008-2016)

This is the author's manuscript

Original Citation:

Availability:

This version is available <http://hdl.handle.net/2318/1705604> since 2019-07-11T11:20:03Z

Published version:

DOI:10.1080/14719037.2019.1618386

Terms of use:

Open Access

Anyone can freely access the full text of works made available as "Open Access". Works made available under a Creative Commons license can be used according to the terms and conditions of said license. Use of all other works requires consent of the right holder (author or publisher) if not exempted from copyright protection by the applicable law.

(Article begins on next page)

Too big to fail? The dynamics of EU influence and fiscal consolidation in Italy and Spain (2008-2016)

Diego Badell-Sánchez, Fabrizio Di Mascio, Alessandro Natalini, Edoardo Ongaro, Francesco Stolfi and Tamyko Ysa

Abstract

The article studies the dynamics of fiscal consolidation and public sector reforms in Italy and Spain under the EU governance that took shape as a reaction to the Eurozone crisis. We show how three types of EU pressure – fiscal and economic coordination rules, conditionality, and backroom diplomacy have operated in conjunction. We also show that Italy was more willing than Spain to resist EU pressure. Based on a Two-Level Game framework, we argue that this can be explained by the greater opposition to European integration that has developed in Italy compared to Spain.

Keywords: European Semester, Fiscal Governance, Austerity, Sovereign debt crisis, Fiscal Retrenchment

Introduction

The financial crisis of 2007–08, which in turn triggered an economic and a fiscal crisis, led to significant changes in the economic governance of the European Union (EU). The findings of comparative and single case studies show that the nature of EU intervention into domestic reform processes has changed, with an enhanced focus on fiscal consolidation, increased surveillance and enforcement of EU measures (de la Porte and Heins, 2015).

This contribution studies the dynamics of public sector reform and fiscal consolidation in EU Member States (Kickert and Ongaro, 2019; Kickert and Randma-Liiv, 2017; Ongaro, 2014). This comparative case study of Italy and Spain is part of a collective effort (this special issue) to try to improve our

understanding of the phenomenon of fiscal consolidation in Eurozone member states and its fallouts, which has had - and is having at the time of writing - a transformative effect on EU governance and it has elicited both an academic interest in understanding the changed EU governance resulting from these adjustments, and, more from a policy standpoint, a political and policy interest for its repercussions on the political life of many European countries and the EU as a whole.

Specifically, we focus on two aspects: the operation of several types of pressure exerted by the EU institutions on the Member States towards fiscal consolidation, and the conditions under which Member States may choose to resist these pressures. Recent work has assessed the operation of three types of EU pressure on domestic policy: fiscal and economic coordination rules, conditionality, and backroom diplomacy (de la Porte and Natali, 2014; Sacchi, 2015). We show that the effectiveness of these different types of pressure (channels for short) depends on how they interact with each other, and we try to outline some of these interactions, by using the comparative study of fiscal consolidation in Italy and Spain.

Italy and Spain are both large Member States, and size, both in terms of a country's economy and of its representation within the EU institutions, might give them the power to resist pressures coming from these institutions as well as from other Member States (Baerg and Hallerberg, 2016). At the same time, countries coping with major budget imbalances, like Italy and Spain, have been more vulnerable to market pressures and thus potentially more dependent on the financial support coming from the EU.¹

We show that, although Italy and Spain share these important contextual dimensions, their governments have differed in terms of their willingness to resist EU pressures, and we explain this different outcome based on the different evolution of the party systems and of Euroscepticism in the two countries.

The evidence covers the period from the onset of the crisis in 2008 to 2016, and it comprises official EU and national documentation –from the Ministries of Economy and Finance, the European Commission, and the International Monetary Fund (IMF), records of Parliament sessions and transcripts of parliamentary committees' meetings. The findings have been cross-checked through triangulation by

conducting 15 in-depth semi-structured elite interviews (the list of the interviewees is reported in the Appendix).

The rest of the article is organized as follows: the first section places the article in the context of the relevant literature; the second section discusses the case selection strategy; the third section follows the impact on fiscal consolidation and public sector reforms of EU fiscal governance rules, conditionality, and backroom diplomacy; the final section discusses the results and concludes.

Review of the literature

The economic and financial crises, the changes in EU governance to respond to the crises, and the EU requests for fiscal austerity and structural reforms (often supported also by domestic actors, Dukelow 2015), have combined to exert significant pressure on Member States along all three canonical dimensions identified by the Europeanization literature, namely in terms of domestic institutions, policies and politics (Börzel and Risse, 2003).

With regard specifically to fiscal and public sector reforms, several issues have come to the fore: how fiscal retrenchment has been carried out and how it has impacted the functioning of government, whether the imperatives of crisis control and the pressures coming from the EU have led to the centralization of governance, and whether the crisis and EU pressures have facilitated or hindered reform. Retrenchment has generally been effected through across-the board cuts - rather than targeted and thus politically risky savings (Di Mascio et al. 2017; Ongaro et al., 2015; Randma-Liiv and Kickert 2017). A frequent response to the fiscal crisis has also been centralization, whether *qua* concentration of powers within the executive and government organizations in the hands of fiscal decision-makers (Randma-Liiv and Kickert, 2017), or concentration of powers in the executive to the detriment of Parliament (Savi and Randma-Liiv, 2015). Finally, the requirements of fiscal retrenchment and the time pressures when the crisis hit have often

militated against the implementation of structural public administration reforms (Ladi, 2014; Di Mascio and Natalini, 2015; Lampropoulou, 2018).

The impact of the crisis has also been assessed with regard to welfare state reforms in the Member States most severely hit by the crisis. It has been argued that in order to better understand Europeanization and the way it affects Member States, we need to focus more on the changing face of Europeanization itself (Ladi and Graziano, 2014). The response to the crisis reveals that, when Member States have not been implementing EU measures in a context of sovereign debt crisis, Europeanization becomes intrusive with very specific policy objectives, detailed timetables, close monitoring, and high enforcement (Theodoropoulou, 2015). However, the overall extent of this intrusiveness has varied across countries and policy domains as reinforced economic governance tools do not undermine the relevance of the national politics.

In their analysis of the Europeanization of pension reform in Denmark and Italy, De la Porte and Natali (2014, 734-735) have adapted the “two-level game” framework (Putnam 1988) to the study of reform processes involving EU and domestic levels of governance. In the adapted framework three adjustment pressures have provided EU-level actors with leverage to push reform through in the aftermath of the crisis: formal fiscal and economic coordination rules; conditionality, i.e. the promise of financial support by EU institutions to Member States in order to induce structural reforms and spending cuts; and “backroom diplomacy,” i.e. “the informal negotiations used by the EU and the most powerful member states to convince domestic policy-makers to introduce the reforms proposed by the EU” (De la Porte and Natali 2014, 735-736). With regard to conditionality, Sacchi (2015) has shed light on the “implicit” variant at work in Italy, which refers to EU institutions using informal inducements and penalties, i.e. not supported by explicit and formal agreements, to steer the behavior of the Member States.

Building on the work by Sacchi and by de la Porte and Natali, we track three types of pressure: fiscal and economic coordination rules, conditionality, and backroom diplomacy. We extend the scope of their

analysis by including a new country (Spain) and by carrying it out over a longer period of time (until 2016) and over a broader set of policies (including structural reforms and fiscal retrenchment). Like them, we further emphasize market pressures as a key contextual factor. Unlike them, but consistently with Pavolini et al. (2015), we also point to the interaction among these various types of pressure, in particular with regard to backroom diplomacy. Specifically, the first contribution of this article is to show that backroom diplomacy has shaped the impact of conditionality.

Yet another strand of the literature has investigated the institutional evolution of the EU. Fast-paced institutional change has been required by the need to address two urgent and interlinked issues: how to bring together national systems of bank supervision and resolution so as to ensure the stability of the European banking system (Howarth and Quaglia, 2014; Quaglia and Spendzharova, 2017); and how to provide financial support to high-debt countries in a way that upholds the no-bailout principle, one of the foundations of the EMU, which aims to forestall moral hazard problems and to reassure Northern European voters.

Financial support to Member States in difficulty has been provided through new bodies, first the European Financial Stability Facility and then the European Stability Mechanism. The disbursement of funds has been linked to an increasingly specific schedule of reforms and spending cuts spelled out in Memorandums of Understanding with the recipient countries. In order to prevent future crises, fiscal and economic coordination among Member States, especially those belonging to the EMU, has been strengthened. The original fiscal framework (the Stability and Growth Pact, SGP) has been reformed with the addition of a new system of rules (the so-called Fiscal Compact, Six-Pack and Two-Pack) that are brought together into the European Semester (ES), a single process of economic and fiscal coordination, surveillance and enforcement (Verdun and Zeitlin 2018).

This also raises the question of how institutional developments with regard to EMU governance affect the relationship between EU institutions and Member States with regard to public sector reforms, both

with regard to the transmission mechanisms and the content of policies. Some lament the subordination of social policy to fiscal goals (Crespy and Menz, 2015) or note that the framework designed to coordinate employment and social policy and further develop the European Social Model is comparatively weak compared to the sharpened objectives, surveillance, and enforcement in the EMU (de la Porte and Heins, 2015). Others see a growing emphasis on social objectives in the Semester's policy orientations complemented by significant revisions to its decision-making arrangements, which have made them less intrusive and more interactive (Zeitlin, 2016; Zeitlin and Vanhercke, 2018).

This article advances this debate by analysing how austerity affects the way Member States participate in the process of economic and fiscal coordination, and in particular the conditions under which they might choose to resist EU pressures. Since the Maastricht Treaty, economic and fiscal coordination in the EU has included the Member States as crucial actors alongside the Commission, approving the EU's economic guidelines, deciding on the start of an Excessive Deficit Procedure (EDP) in the Council of the European Union (Council), and providing the data on which the Commission's assessments are based. The Six-Pack and the Two-Pack have confirmed the integration of inter-governmental and supranational elements in the EU's economic and fiscal governance. They have retained, although now by reverse Qualified Majority Voting, the role of Member States in deciding on EDPs, and have extended it to the new Macroeconomic Imbalance Procedure (Armstrong, 2013). With the ES, one might say this integration has become even closer, as in the context of the ES cycle the Commission engages in regular multilateral and bilateral dialogue with several actors representing the Member States (Verdun and Zeitlin, 2018).

Baerg and Hallerberg (2016) further show that the Commission's proposals for the opening of an EDP tend to be watered down by the Council when they affect the larger Member States, and especially Germany and France. Finally, Baerg and Hallerberg show, countries where there is greater voter opposition to European integration are also able to change the EDP recommendations in their favor, a

finding confirmed with some caveats by Mariotto (2018), and consistent with the further finding that Member State governments tend to be more opposed to proposals in the Council of the European Union to extend EU powers if the respective national public opinions are more hostile to European integration (Hagemann et al., 2017).

These findings point to the fragility of EU economic governance in the context of the mounting populist and anti-EU wave across several Member States, and raises the question of which strategies are open to Member States. With the passing away of the “permissive consensus” on European integration (Hooghe and Marks, 2009) and the rise of populist parties, domestic public opinion has become increasingly important, not only as a constraint on the governments, but also, we suggest, as an asset governments can use. Governments can exploit voters’ resistance to EU integration as an asset to strengthen their negotiating position within the process of EU governance. At the same time, the pro- and anti-European integration cleavage in domestic politics has become especially salient precisely in the countries whose economies have been most negatively affected by the crisis (Otjes and Katsanidou, 2017).

Following the burst of the financial and economic crisis, Spain and Italy have been under similar pressures to implement an austerity strategy, and their governments have used similar rhetorical strategies to convince the public (Leon et al. 2015) However, austerity has gone much further in Spain than in Italy. This has been explained due to Spanish governments being more insulated from societal pressures than Italian ones and to the higher electoral importance of government spending in Italy than in Spain (Perez and Matsganis, 2018). A similar argument, based on the relative importance of clientelistic strategies for parties, has been made to explain the differences in fiscal retrenchment between Greece and Portugal (Afonso et al. 2015). Pavolini et al (2015), in an analysis that parallels ours, assess the impact of crisis and European integration on the welfare state in Italy and Spain. They find that this impact varies systematically in the two countries across different pillars of the welfare state (corporatist,

i.e. pensions and labor markets, universalist, i.e. health and education, and targeted policies such as social and family policy).

We add to the comparative analysis by Leon et al. (2015), Perez and Matsganis (2018) and Pavolini et al. (2015) by pointing to the role of degree of Euroscepticism (much greater in Italy than in Spain) and the evolution of the party systems: in Italy, parties espousing formerly fringe views have become increasingly successful and have brought to the fore new cleavages in societies (including on European integration); in Spain, the party system has remained firmly, during the observed period, within the established left-right cleavage (although with new parties as protagonists), and thus European integration has not become politicized.

Case Selection

Our case selection follows the logic of a “Most Similar Systems Design” (Przeworski and Teune, 1970), namely one that aims to keep constant as many significant contextual factors as possible in order to assess the potential impact of the key causal factor that differs between the cases. Italy and Spain share several relevant similarities (Ongaro, 2009). First, their financial stability was at risk at the cusp of the Euro crisis, meaning that their reform processes shared the same level of vulnerability, which is understood here as an intervening variable at work when the Eurozone is threatened by a sovereign debt crisis in one of its member States (de la Porte and Natali 2014, 736). Second, in contrast to smaller Greece, Portugal and Ireland, their size would make a full bailout practically impossible. Therefore, neither of the two was formally bailed out and subjected to official reform conditions. To be precise, Spain did in fact enter a financial assistance programme from the European Financial Stability Facility in July 2012 for the recapitalization of its banks. However, this did not include specific conditions outside of the financial sector, except a commitment to country-specific reform recommendations in the context of the Stability

and Growth Pact. Third, the two countries have similar economic models, welfare states and administrative systems (Picot and Tassinari, 2017).

In combination with the similarity of EMU vulnerability and size of economy, the similarity of domestic contexts has led scholars to expect analogous reforms trends (Sotiropoulos, 2015). Even if both governments have been subjected to ‘implicit conditionality’ (Sacchi, 2015), Italy was able to exercise greater leverage than Spain vis-à-vis reform pressures from the EU level as revealed by the softer fiscal adjustment and the slower pace of structural reforms.

To explain this difference, we focus on the political determinants of country-specific outcomes under shared exposure to implicit conditionality (Perez and Matsaganis, 2018). In particular, we refine the research argument that large eurosceptic Member States are positively associated with weakening EU recommendations (Baerg and Hallerberg, 2016). While the euro crisis has reshaped the nature of party competition in Europe by prompting the exodus of voters from mainstream parties (Hobolt and Tilley, 2016), the impact of the crisis on South European party systems has not been uniform (Morlino and Raniolo, 2017).

Research on Italy has shown the emergence of a distinct pro-/anti-EU (European Union) dimension structuring party competition (Giannetti, Pedrazzani and Pinto, 2017), which is due to the rise of a brand new party (*Five Star Movement-M5S*) since 2009. The success of this challenger party contributed to alter the main feature of the Italian party system, that is the alternation in government between centre-left and centre-right coalitions. Party system change started in 2011 when a grand coalition between the main centre-left and centre-right parties was formed to support a technical government. Then, the unexpected success of the M5S at the 2013 general elections led to a hung Parliament before the formation of a new grand coalition followed by a surplus majority coalition of centre-left parties.

With regard to Spain, the impact of the crisis has not affected the established two-party system until 2015 when the general elections generated a fragmented parliament with no clear majority (Hopkin 2015).

Two new parties (*Podemos* and *Ciudadanos*) came into play that challenged the dominant position of the traditional mainstream centre-left (Socialist Party-PSOE) and centre-right (People's Party-PP) parties (Orriols and Cordero, 2016). After five months of unsuccessful negotiations to form a government, a new round of elections was called for June 2016. The People's Party (PP) emerged as the largest party, securing the most seats but just as in the previous election, it failed to win an overall majority. However, the Parliament allowed the conservative leader to lead a minority government after a 10-month political stalemate. In contrast to Italy, the emergence of new parties in Spain is not a consequence of new dimensionalities of conflict (Vidal, 2018). The structure of political competition has remained unidimensional, meaning that Podemos capitalises on the critical voters on the left while Ciudadanos does so on the right.

Table 1 summarizes the different trajectories of party system change that occurred in Italy and Spain in the period under examination (2008-2016). Major differences concern: the single party vs the multi-party composition of cabinets; the timing of the political stalemate promoted by the rise of challenger parties; the uni-dimensional vs the multi-dimensional structure of political competition in the aftermath of the crisis. Party system change has helped shape government responsiveness to domestic protest (Perez and Matsaganis, 2018): whereas in Italy the rise of the Five Star Movement has increased the responsiveness of governments to protest in a context of political and institutional fragmentation where multi-party coalitions operate in a strong bicameralism, the rise of Podemos and Ciudadanos has not altered the traditional lack of responsiveness to protest by single party governments.

[TABLE 1 ABOUT HERE]

Finally, the different evolution of the two countries' party systems has been mirrored by the difference in popular support for EU integration. Already before the crisis, Italian voters were significantly less pro-

European than Spanish ones (European Commission, 2007). By 2016, 42% of Italian respondents to the Eurobarometer survey were in favour of their country leaving the EU, against 24% in Spain and 32% on average across the EU Member States (European Commission, 2016).

Empirical Analysis: The threechannels of EU–Member States interaction in matters of fiscal consolidation and public sector reform

This section analyses the channels of EU influence on the dynamics of fiscal consolidation and public sector reform in the countries investigated, and the dynamic interactions between the national and the supranational level that occurred during the 2008-2016 period. The channels of influence are: formal rules and procedures, conditionality, and backroom diplomacy. They are analysed in sequence in this section. We will discuss them in a more integrated fashion in the final section.

Formal rules and procedures: Italy

Although the Italian banking system was not badly hit by the financial turmoil, the country suffered from chronic fiscal imbalances; it had lived with a high level of public debt (mostly held domestically), but posted primary surpluses for decades. In this context of precarious state of public finances, the economic recession triggered by the global financial upheaval severely hit the Italian economy, which was already weakened by a decade of low growth (Quaglia and Rojo, 2013). Yet, the Berlusconi government did not address concerns about the sustainability of the high level of debt in a context of economic recession as revealed by the largely budget neutral measures that were adopted in the first year of its mandate, including the postponement of the adjustments to the pension system until 2015 (Law Decree 78/2009). As a result, in late 2009 the European Commission opened an EDP, as the Italy's budget plans showed a non-temporary breach of the SGP deficit targets, though it acknowledged the extraordinary nature of the economic fallout deriving from the subprime crisis.

Recommendations from the EU level became effective in the first half of 2010 when the interest rates on the Italian sovereign debt soared (Italy, Interview #1). In an attempt to assuage the concerns of financial operators – and dampen speculative operations - the Berlusconi government anticipated the enactment of the fiscal correction package moving it forward from its mandatory deadline in mid-October to the summer (Law Decree 78/2010). According to the Commission’s assessment, this package represented adequate progress towards the correction of the excessive deficit by 2012 as outlined by the Council Recommendation of December 2009 (Italy, Interviews #2 and #7). The package was mainly aimed at freezing public employment expenditure as well as cutting transfers to local government (Di Mascio, Natalini and Stolfi, 2013). As for economic growth, it was not sustained by structural measures that were advocated by the EU like pension reform, liberalization of services, and flexibility of labour market.

However, financial market pressures on the Italian debt were mounting, reaching new heights in early July 2011, when the interest rate spread between Italian and German government bonds skyrocketed. The Finance Minister Tremonti unsuccessfully advocated the mutualisation of sovereign debt among EU member states with the so-called ‘Eurobonds’ before introducing two emergency fiscal packages that reinforced cuts to public employment and local government as well as raising revenues, so that the government could commit to achieving a balanced budget by 2014 (Law Decree 111/2011; Law Decree 138/2011).

This effort, however, was insufficient to reassure the markets about the prospects for growth since deficit reduction was not complemented by structural reforms to stimulate economic performance (Jones 2012). The Italy-Germany interest rate spread continued to rise leading to *ad hoc* intervention by the ECB followed by the collapse of the Berlusconi government (see the section on implicit conditionality). Market pressures only abated in 2012, when the President of the ECB famously announced his commitment of the ECB to do ‘whatever it takes’ to defend the integrity of the Euro-zone.

A further significant fall in government bond yields occurred in May 2013 when the EDP against Italy was closed as a result of the strict fiscal discipline which had been introduced under the Monti government. The decision was much awaited by the newly formed Letta government since the closing of the procedure allowed it to boost spending (Italy, Interview #4). The new Prime Minister was supported by the same grand coalition that had backed Monti and it was vulnerable to the charge of being another unelected leader. In a context of rising support for challenger parties, Letta found it difficult to enact structural reforms. The latter had been recommended by the European Commission but they were opposed by the partners of the grand coalition, most notably centre-right parties that blamed EU for plunging Italy into a never-ending recession. The lack of competitiveness adjustments led the Commission to rebuff a subsequent request for additional public spending in autumn 2013, as revealed by the warning that Italy should keep its commitment to the previously agreed debt reduction targets, which was issued after the Commission reviewed for the first time the draft budgetary plan in accordance with the “Two-Pack” Regulation on the strengthening of budgetary monitoring (European Commission 2013).

The inflexible application of rules by the Commission boosted the rise of the new leader of the Democratic Party, Matteo Renzi, who finally pushed Letta out of power in February 2014. Renzi called for a change of course in Europe since austerity could not guarantee fiscal stability in the face of rising anti-EU attitudes and economic stagnation (Italy, Interview #8). Renzi asked for existing rules to be flexibly applied in exchange for serious commitment to a package of structural measures, including a bold labour market reform that was enacted in December 2014 (Law 183/2014). In Spring 2014, fiscal plans called for a slower path to the achievement of a balanced budget in structural terms, moving the deadline from 2015 to 2016; in the following autumn, the post was pushed further, from 2016 to 2017 in order to accommodate expansionary measures. As clarified by the Finance Minister in a letter to European Union Commissioners (Padoan, 2014), the government had designed a fiscal strategy aimed at

implementing a growth-friendly adjustment that tried to minimize the risk of self-defeating fiscal consolidation in terms of weak economic activity offsetting any fiscal improvement. The government also remarked that public debt dynamics remained negatively affected by weak growth and other factors which were independent of national fiscal policy. The latter had delivered impressive results as testified by twenty years of primary surpluses.

Yet, the European Commission (2014) assessed the risk of non-compliance with the SGP of the draft budgetary plan. In order to address the Commission's recommendation, the budget law introduced new fiscal consolidation measures, even though the 2017 deadline for a balanced budget in structural terms was not changed. Starting in late 2014 and then in 2015 the economy began to slowly pick up. The government decided to continue with its more expansionary stance, encouraging the newly appointed Juncker Commission to apply the new approach of flexible application of SGP rules (European Commission 2015a; Italian Ministry of Finance 2015). In Spring 2015, the government requested that the Commission apply to Italy the fiscal flexibility granted to countries under the structural reform and investment clauses (worth 0.4% of GDP, increased by the government to 0.8% in the following autumn so as to include the costs associated with the exceptional circumstance of the Syrian refugee crisis), while the deadline for the balanced budget in structural terms was pushed to 2018. A flexibility margin was eventually granted by the European Commission (2015b) after assessing the risk of non-compliance of the draft budgetary plan with the SGP requirements.

The immigrant inflows across the Mediterranean and the earthquakes that struck Central Italy in August and October – demanding additional emergency public spending – further increased tensions in late October-early November 2016. In a letter sent to the Italian government the Commission stressed that Italy had already benefited from significant flexibility under the rules of the SGP in both 2015 and 2016 (Dombrovskis and Moscovici, 2016). In its reply to the Commission, the government insisted that it should have been granted additional flexibility in meeting fiscal targets considering the extraordinary

nature of the expenditure required to cope with the emergencies (Padoan, 2016). The outcome was a partial concession on the part of the Commission with regard to the structural part of the fiscal consolidation process, drawing on the assessment of the risk of non-compliance with the SGP for the fourth consecutive year (European Commission 2016a). Although an additional deficit margin was granted to the government for the third consecutive year, the Prime Minister found himself with insufficient fiscal room against overwhelming political opposition, and he resigned after being roundly defeated in the referendum vote on a constitutional reform package in early December 2016. The referendum defeat revealed the fallacy of Renzi's political calculation that the bold labour market reform enacted in 2014 to abide by conditionality would have provided more leeway by the Commission in the fiscal policy as well as attracting voters in the centre of the political spectrum (Picot and Tassinari, 2015). The defeat in the referendum revealed that the inclusion of active labour market policies in a reform targeting the protection of workers from dismissal did not succeed at the polls in striking a balance between a centrist and a genuinely left agenda (Sacchi and Roh, 2016).

Formal rules and procedures: Spain

At the onset of the global banking crisis in 2007, Spain had a surplus in its budget and its public debt was much lower than Italy's (Kickert and Ysa, 2014). The first response of the newly elected Zapatero government to the economic recession that reached the country following the global banking crisis was the adoption of an expansionary budget as a counter-measure to what was portrayed as a temporary slowdown. Since the economic recession worsened in 2009, the fiscal stimulus contributed to breach the SGP targets as the government balance drifted from a 1.9% surplus (2007) to an 11% deficit (2009). Consequently, the Council opened an EDP on Spain in April 2009, calling for fiscal imbalances to be corrected by 2012. Since the Socialist government was considered to have taken effective action in compliance with the Council recommendation of April 2009 in a context of unexpected adverse

economic events, a new deadline for correction of excessive deficit by 2013 was set in December 2009. In July 2010 the Commission considered that no further steps in the EDP of Spain were needed in light of the consolidation measures that the Zapatero government had adopted in May under the pressure of the other Eurozone members (see the section on backroom diplomacy).

Since December 2011, the newly elected Rajoy government wrestled with the Commission over fiscal adjustment. It operated on an extension of the 2011 budget until the end of March 2012 when the Andalusia regional election took place, and this raised concerns in the capital markets. It was the first major electoral test for the new government and in the run-up to the election the new Prime Minister Rajoy announced that Spain would have a deficit of 5.8% of GDP at the end of the year, and not the 4.4% previously agreed with the EU institutions. Rajoy had been asking to review the deficit targets in light of the protracted economic recession, but the Commission had not granted greater flexibility. The Commission insisted that Spain had to meet its targets and Rajoy finally agreed to cut the deficit to 5.3% in 2012. Cuts affected the health and education sectors that are under the responsibility of regional governments while pensions were not touched. A Stability Law was also adopted to enforce fiscal discipline at all levels of government (Organic Law 2/2012 of April 27).

However, consolidation measures were adopted in vain since the banking crisis worsened and turned into a severe sovereign debt crisis. In early June 2012 the Rajoy government called for the financial rescue of Spanish banks by European partners. The executive was able to avoid the humiliation of a full bailout and no macroeconomic conditionality was attached to the financial assistance for the recapitalization of Spanish banks (see section on implicit conditionality in Spain). In parallel to the financial assistance programme, Spanish authorities were expected to report on progress made under the EDP and the European Semester on a quarterly basis.

On 10 July 2012, the Council consented to a relaxing of the deficit goal for the current year from 5.3 to 6.3% and postponed the deadline for the correction of excessive deficit from 2013 to 2014. This decision

took account of continuing economic difficulties and was a reward for the major fiscal consolidation package (amounting to 65 billion euros) announced in that week by the Spanish government. Rajoy agreed on increasing the VAT from 18 to 21%, a measure it had previously rejected, and introduced stricter rules for early retirement (Royal Decree 5/2013 of March 5). In June 2013, the Council concluded that Spain had taken effective action but adverse economic events with major implications on public finances had occurred, and postponed the deadline for correction of excessive deficit to 2016. The Council also endorsed planned reforms that were adopted by the end of 2013: the introduction of an independent fiscal council to provide advice and monitor consolidation measures (Organic Law 6/2013 of November 14); a long-awaited major pension reform abolishing the indexation to inflation as well as linking the amount of future retirees' new pensions to changes in life expectancy (Act 23/2013 of December 2013); a programme of administrative reform (CORA) targeting overlap and duplication between different public bodies and levels of government with a view to reaping efficiency gains.

On 12 October 2015, the Commission delivered its opinion on Spain's 2016 draft budgetary plan, which was submitted on 11 September 2015, ahead of the deadline of 15 October. Due to its early submission, related to the timing of Spain's parliamentary elections scheduled for 20 December, the draft budgetary plan incorporated the central government budget that was adopted by the government on 31 July 2015, but did not include up-to-date and fully specified measures for regional governments. In March 2016, the Commission recommended to take measures for a timely and durable correction of the excessive deficit, including by making full use as appropriate of the preventive and corrective tools set out in Spain's 2012 Stability law to control for slippages at the subcentral government level from the respective deficit, debt and expenditure rule targets. In response to the Commission Recommendation of March 2016, the caretaker government announced that it would implement provisions in domestic legislation to enforce fiscal discipline on regional governments. To that end, on 6 April, it called on 12 regional governments to approve cuts in budget appropriations to ensure compliance with their deficit targets.

In July 2016 the European Commission (2016b) highlighted that better-than-expected economic developments had not been used to accelerate the deficit reduction since 2014, and the fiscal stance was expansionary in 2015. Spain was indeed held responsible for not taking steps to correct its excessive deficit in 2016. Therefore, it threatened to sanction the Spanish government with penalties worth 0.2% of GDP. The caretaker government submitted a reasoned request to the Commission to recommend that the Council set the amount of the fine to zero. In support of its request, Spain highlighted that the consolidation fatigue of 2014-2015 had a negative direct impact on public finances, but it supported social cohesion as well as contributing to growth in the medium to long term. The caretaker government also announced its commitment to put in place further deficit-reducing measures (Spanish Government 2016). In view of this commitment and having regard of the deep structural reform efforts undertaken by the Spanish government since 2012, the Commission agreed on the cancellation of the fine and postponed the deadline for correction of excessive deficit to 2018 (Hodson, 2017).

Implicit conditionality: Italy

In August 2011 market operators perceived Italy as the weakest link of the Eurozone as revealed by the sudden increase of the spread between Italian and German long-term government bonds. Market attitudes reacted to the indecisiveness of the Berlusconi government resulting from deep divisions within the cabinet since the key coalition partner, the Northern League, staunchly opposed reforming the seniority pensions (Jones, 2012). The ECB reacted by expanding its remit beyond monetary policy in August 2011. Even though Italy did not demand financial aid and did not sign any memorandum of understanding, conditionality was introduced (de la Porte and Natali, 2014; Di Mascio et al., 2019; Sacchi, 2015). The ECB announced a plan to purchase Italian government bonds in order to keep yields under control, in exchange for a set of detailed commitments. The ECB President and the Governor of the Bank of Italy sent to the Berlusconi government joint letter delineating a precise course of action for the government

to adopt. Although the letter was informal, it contained extremely stringent pressure (in terms of reform outputs and regulatory instruments to use), thus representing implicit conditionality. The nature of the deal (the offer to buy Italian government bonds on the secondary market in exchange of detailed commitments, including an acceleration in the path to balancing the budget by one year) was new but it revolved around the same set of reforms that the EU had advocated for a decade.

An emergency package was approved in mid-August with the aim of reaching a balanced budget in 2013 as requested by the ECB. However, the government could not agree upon structural reforms. As a reaction to the lack of serious commitment to reform efforts, the European Council of 22-23 October 2011 mandated the Commission to monitor the implementation of the vague commitments made by the government, an unprecedented form of informal conditionality (Sacchi, 2015). On 11 November 2011 the Berlusconi government resigned after the 2012 budget law was passed in Parliament. The immediate launch of painful fiscal consolidation measures by the new ‘technical’ executive led by the former EU Commissioner Monti entailed a significant improvement in the credibility of the Italian government towards international institutions and financial operators. Within a few months, the international monitoring was scaled back, with the IMF returning to its yearly reporting schedule, and the ECB providing new liquidity in December 2011.

So as to further consolidate market confidence about the credibility of its commitments, the new government acceded to the Fiscal Compact (Moschella 2017, 217). This implied the introduction of stricter fiscal rules, as recommended by the ECB in its confidential letter. In line with the Fiscal Compact, the government pushed Parliament to enact a range of measures: introduction of the balanced budget principle into the Italian constitution in April 2012; adoption by a qualified majority of a “reinforcement law” to define the exceptional circumstances and the corrective mechanisms in case of significant deviations from fiscal targets in December 2012; establishment of an independent parliamentary budget

office with the tasks of monitoring the respect of the EU fiscal rules and providing independent economic forecasting.

Another set of recommendations by the ECB regarded the launch of ambitious structural reforms. With regard to this target, the effectiveness of the channel has been checkered: while the liberalization of the labour market has been set in motion (Law 92/2012), a bill to liberalize services has been watered down by parliament after pressures from interest groups supporting coalition parties (Mattina, 2013). Pressures from interest groups has also implied that fiscal consolidation has been achieved mainly through revenue increases whereas the ECB called for cuts to public expenditure. Further, constitutional disputes put an halt to the removal of duplications between public bodies and administrative layers of government, which had been requested by the ECB.

It is also worth noticing that the joint ECB-Bank of Italy letter has triggered a contentious public debate when its contents were leaked by a major newspaper, since a large part of Italian public opinion perceived it as an undue and intrusive influence on domestic politics. This debate further contributed to the rise of anti-EU attitudes as revealed by disappointing results of the parties supporting the Monti government at the 2013 general elections.

Implicit conditionality: Spain

In early August 2011, the ECB President jointly with the Governor of the Bank of Spain wrote a letter to Zapatero before resuming the Securities Market Programme (SMP) whereby the ECB directly purchased Spanish government debt. The letter emphasized that Spain had to improve its fiscal credibility if it was to keep counting on European support in front of a pressuring market discipline. Although the Spanish government did not ask for financial aid nor signed any Memorandum of Understanding, the informal letter contained extremely stringent requests with regard to fiscal policy and labour market reform.

Structural measures introduced in 2011, like the reform of collective bargaining (Royal Decree 7/2011) and the adjustments to be gradually implemented between 2013 and 2027 with regard to the sustainability of the pension system (Act 27/2011), were considered by the ECB as not far-reaching enough. These reforms were moderate to avoid compromising the traditional support of trade unions to the socialist party (Jordana, 2014). Although the ECB letter made no explicit link to bond purchases, its closing paragraph sounded like a warning and it generated a substantial amount of outrage when Zapatero finally disclosed it as part of his memoirs in 2013.

Until then, its existence had been denied by Zapatero because its release would have put stability at risk. In the context of the debate on a Royal Decree introducing a new round of emergency austerity measures to be approved by the parliament before its early dissolution in September 2011, the leader of the opposition Rajoy formulated two parliamentary questions about the existence of the confidential letter and of any conditionality measures. The Prime Minister declined to answer either question and announced a reform of the Spanish constitution. This move, which preceded the Fiscal Compact introducing a balanced budget rule, was aimed at winning back market confidence (Interview Spain #6). The introduction of a cap on future deficits had been demanded for years by the Popular Party and this pushed through constitutional change in August 2011. The balanced budget constitutional amendment received the support of the two major parties, the Socialist party (PSOE) and the People's Party (PP), which together had more than 90% of deputies.

At the general elections of November 2011, the PSOE suffered its worst ever defeat. When the PP leader Rajoy took over as the new Prime Minister, he revealed the existence of the secret letter, which was also admitted by the ECB without disclosing its contents. Under rising market pressure, the Rajoy government placed its emphasis on cutting expenditure in the field of social policy. A new labour market reform (Royal Decree 3/2012 of February 10) extensively deregulated dismissal protection as well as squeezing collective bargaining (Dubin and Hopkin, 2014). However, labour market reform was not merely a

requirement imposed by external actors; it was also an opportunity seized by the PP to pursue a longer term ambition of reshaping the structure of political competition by weakening the clientele traditionally attached to the PSOE. Recommendations that were not coherent with this ambition – increasing investments in active labour market policies, increasing tax with revenues making up for reduction in social security contributions, more aggressive liberalization of services – have not been implemented by the conservative government (Cioffi and Dubin 2016, 441-442).

A financial assistance programme for the recapitalization of Spanish banks was agreed by the Eurogroup on 9 July 2012. The Memorandum of Understanding did not link recapitalization with macroeconomic conditionality but Spain was expected to fulfil its commitments under the EDP and implement structural reforms within the framework of the European Semester. In parallel with the financial assistance programme, a second government bond buying policy was introduced by the ECB in September 2012: the Outright Monetary Transaction (OMT) programme, which included Spain and contributed to a steady decrease of market pressures.

Backroom diplomacy: Italy

Pressure via backroom diplomacy from Eurozone leaders, in order to affect the Italian fiscal policy and consolidation, occurred most notably in 2011, in the context of severe market pressures and political turmoil stimulated by the lack of credibility of Berlusconi. When it became clear that despite the letter from the ECB and the Bank of Italy, domestic policy-makers were not able or willing to pass radical measures, most notably the reform of seniority pensions, the Franco-German leaders took over the negotiations with the Berlusconi government from the ECB. At the Cannes G20 meeting in early November, the leaders pressed Berlusconi not only to specify the fiscal consolidation strategy, but also to take a precautionary financing from the IMF. The Italian government rejected this proposal, but it accepted IMF oversight of consolidation measures and related reforms (Jones, 2012; Henning, 2017).

This pressure deprived Berlusconi of his last source of legitimacy and he agreed to resign, but only after the Parliament passed the amendments to the stability legislation. This raised uncertainty in the markets, leading the Eurozone leaders to address the highly-esteemed President of the Italian Republic calling for an immediate change of government, which occurred in November 2011.

As a result, a new technical government was voted into office, led by Monti, former EU Commissioner, a person highly respected in EU circuits as well as in the world of international finance (Di Mascio et al. 2017). Soon the new government approved an austerity plan to control public spending and to reduce the national debt, including measures on seniority pensions (Law Decree 201/2011). All this was consistent with the detailed measures proposed by the ECB letter. Consequently, the German and French governments informally gave the ECB the green light to provide new liquidity (Stolfi, 2013). This contributed to a severe loss of trust towards EU institutions since their role is lumped together with the responsibility of core member states and their leaders, Germany *in primis*, in the view of Italian citizens and political elites as revealed by survey data (Olmastroni and Pellegata, 2018).

Backroom diplomacy: Spain

This channel emerged during the ECOFIN meeting of 9-10 May 2010 (Spain, Interview #7). Over that weekend, Merkel and Sarkozy called for an immediate and sizeable cut in the Spanish budget (Barbé, 2011). As a reaction to these “unbearable” pressures (Dellepiane-Avellaneda and Hardiman, 2014), the Zapatero government adopted an emergency package (Royal Decree 8/2010 of May 20) that was approved in parliament by only one vote since it sharply intensified the pace and impact of the deficit reduction programme announced in the 2010 Budget, and switched from a revenue-based to a spending-based strategy. It was followed by a labour market reform (Royal Decree 10/2010 of June 16), curbing protection from dismissals, which was unilaterally passed by the government after negotiations with unions failed (Picot and Tassinari, 2017).

At the end of 2010, the budget for 2011 deepened the commitment towards spending-based consolidation, mostly through a drastic cut in public investment in infrastructure, but it continued to protect the core components of the social policy (Dellepiane and Hardiman, 2014). In November 2011, at the G20 Cannes summit Zapatero rejected the proposal advanced by Merkel with regard to a precautionary financing for Spain, highlighting that Spain had taken action as agreed with the other Eurozone members and it was in the middle of an electoral campaign (Henning 2017, 138).

Backroom diplomacy also influenced the design of the financial assistance package in the 2012. During the negotiation over the Memorandum of Understanding, the Trojka required linking bank recapitalization with macroeconomic conditionality and it was supported by the majority of the Eurozone members. The Rajoy government rejected this proposal and it raised the argument of the country's economic weight (Spain, Interview Spain #4 and #5). Bailing out an economy of Spain's size would have caused a capital increase in the IMF, diluting North-American and European control of the IMF, after a large country like China had joined it. At the G20 Los Cabos meeting in June 2012, the Spanish delegation also spread the rumour that the country could be better off outside the EMU (de Guindos 2016). Bilateral negotiation between the Spanish and German governments constituted the solution for getting over the impasse as the two countries agreed on keeping financial sector reform separate from obligations under the EDP and the European Semester (Henning 2017, 141).

Discussion and conclusions

The empirical section has illustrated how the various channels of EU influence have operated in the cases of Italy and Spain during the fiscal crisis over 2008-2016, and notably at the peak of the crisis (for these two countries) in 2010-12. Tables 2 and 3 provide a depiction of the impact of formal rules, conditionality, and backroom diplomacy on the dynamics of fiscal consolidation and public sector reform

in Italy and Spain. They highlight differences in terms of timing, duration and impact of EU influence in the two countries, which implies that domestic politics has been a crucial intervening variable.

Italy and Spain, as other Eurozone governments, found it difficult to commit themselves to fiscal discipline and initially hesitated to implement unpopular measures, as they were weighing the difficulties in keeping the governing coalition cohesive over the implementation of these measures, and the threat of being punished in the subsequent round of elections (Hübscher, 2016). The appointment of executives run by technical (in Italy, 2011-2013) and conservative political elites (in Spain since 2011) ensured higher levels of compliance with recommendations from the EU. Our analysis has also highlighted that political turmoil and stalemate slowed down the pace of fiscal consolidation in both countries. This led leaders emerging from political gridlock like Renzi and Rajoy to call for flexible application of EU rules in light of the “consolidation fatigue” affecting their countries. Renzi, in particular, has used the argument that EU fiscal policy offer fertile ground to challenger parties in the attempt to exchange credible commitment to structural reforms for more flexible application of procedures.

[TABLE 2 ABOUT HERE]

[TABLE 3 ABOUT HERE]

The first channel of influence is comprised of formal procedures, namely policy coordination under the SGP and strengthened surveillance in the case of an EDP. In 2010, the SGP was strengthened by increasing member state accountability and the automaticity of EDPs and sanctions in the case of non-compliance, all coordinated in the European Semester, which has become the linchpin of the new EU governance. The outcome is the development of tighter regulatory frameworks that although formally triggered at the EU level involve a high level of EU-domestic interplay both before and after their formal

initiation – a consideration which leads to weighing in the significance of the other channels and how they interact.

Conditionality, the second channel of influence, has been used extensively for pressing Italy and Spain to solve their fiscal problems under rising market pressures. It is clearly observed in the letters sent to the Italian and Spanish government in the middle of the crisis, which were jointly written by the President of the ECB and the Governor of the respective national banks. However, these letters constituted unique crisis measures that may not be regularly repeated, not least because of the public outrage they inspired in the two countries since they had been disclosed. As revealed by the design of the Spanish programme, since 2012 pressure from EU has been centred on the notions of ownership and commitment, and conditionality has been linked to existing formal procedures (European Commission, 2016c).

With regard to backroom diplomacy, the third channel of influence in the analytical framework, it is observed that Eurozone leaders intruded into domestic politics, and in Italy they even actively supported a political turnover by throwing their weight behind a technical government and legitimising ‘technocrats’ to pass reforms. Furthermore, backroom diplomacy has been particularly influential in shaping the design of influences passing through implicit conditionality: in Italy, when France and Germany gave the green light to the ECB purchase of government bonds; in Spain, when Germany discarded the option of the full bailout hence de facto dictating the form of the conditionality intervention. Four main lessons regarding the effects of the EU post-crisis economic governance can be drawn from this study. They partly confirm the findings of the extant literature on the relevance of domestic politics as intervening variable (de la Porte and Natali, 2014; Perez and Matsaganis, 2018), and partly add to it, by qualifying its results and specifying influencing factors. First, our analysis highlights that deficit reduction and structural reforms have not been the only target of EU influence, which has also focused on another key reform target, namely stricter rules to be embedded within the domestic fiscal framework (Doray-Demers and Foucault, 2017): EU influence aimed at changing the internal constitution (formal

and/or material) of the fiscal framework of the Member States. Thus, the phenomenon of EU-driven fiscal consolidation takes also the form of a process of change of the constitutional arrangements of a member state, hence a transformative process of EU governance (Ongaro, 2014; Ongaro and Kickert, 2019). The ‘material constitution’ of the EU is being modified by EU-driven fiscal consolidation initiatives since the multiple crises burst in 2008/09, and the study of change along the EU governance dimension is as significant as the investigation of the impact of EU pressures on the individual policy fields mostly investigated in the literature.

Second, the resolve of the two governments was strengthened by conditionality, in both cases in the context of severe market pressures. The bite of potential sanctions for fiscal breaches has been apparent only when backed by market pressures. Our study underlines the decisive influence of the intensity of market pressures in qualifying the patterns of decisions taken by EU and national actors (de la Porte and Natali, 2014; Sacchi, 2015).

Third, concerns about the legitimacy of national and EU institutions have emphasized the significant interconnections between rule-based and coordination-based forms of governance within the new economic governance architecture. That is to say, the normative environment for fiscal governance does not rest solely in legally binding rules but in the signalling and steering which emerge out of cyclical processes of policy coordination (Armstrong, 2013). This is captured at least to a certain degree by the backroom diplomacy channel.

Fourth, the ability of the Member States to undermine fiscal supervision has been boosted by the rise of Euroscepticism, especially in Italy. Besides corroborating findings in recent literature highlighting the relevance of domestic politics and policymaking, our study advances this debate by assessing how austerity affects the way Member States participate in the process of economic and fiscal coordination, and in particular the conditions under which they might choose to resist EU pressures. The main condition is the degree to which Euroscepticism becomes politically salient. Euroscepticism, during the observed

period, gained traction to a much greater extent in Italy than in Spain. In Italy, Euroscepticism has transformed the party system, as parties espousing formerly fringe views have become increasingly successful, making European integration a new cleavage in Italian politics; in Spain, the party system has been transformed by the irruption of two new parties, but it has not got beyond the established left-right cleavage, and thus European integration has not become politicized.

Thus, our contribution sheds light on a little-investigated feature that may have a differential effect on the degree and, possibly, shape of the impact of EU pressures on national consolidation, hence adding to the extant literature. It may further be hypothesized that the inhibiting effect of the rise of Euroscepticism in a country may be temporary, and afterwards EU institutions may react with further determination to the threat posed by the weakened fiscal discipline of the newly more Eurosceptic country, but our observation during a period of mounting Euroscepticism (2008-16) shows that at least initially Euroscepticism may have an inhibiting influence by stemming EU pressures towards fiscal consolidation.

References

- Aberbach, J.D. and B.A. Rockman. 2002. "Conducting and Coding Elite Interviews." *PS: Political Science and Politics* 35 (4): 673–76.
- Afonso, A., S.Zartaloudis, and Y. Papadopoulos. 2015. "How party linkages shape austerity politics." *Journal of European Public Policy* 22 (3): 315-334.
- Armstrong, K. 2013. "The New Governance of EU Fiscal Discipline." *European Law Review* 38(5): 601-617.
- Baerg, N.R. and M. Hallerberg. 2016. "Explaining Instability in the Stability and Growth Pact." *Comparative Political Studies* 49(7): 968–1009.

- Börzel, T. and T. Risse. 2003. "Conceptualizing the Domestic Impact of Europe." In *The Politics of Europeanization*, edited by Kevin Featherstone and Claudio Radaelli, 57-80. Oxford: Oxford University Press.
- Cioffi, J.W and K.A. Dubin. 2016. "Commandeering Crisis: Partisan Labour Repression in Spain under the Guise of Economic Reform." *Politics & Society* 44(3): 423-453.
- Crespy, A.and G. Menz. 2015. *Social Policy and the Eurocrisis*. Hampshire: Palgrave Macmillan.
- De Grauwe, Paul and Yuemei Ji. 2014. "How Much Fiscal Discipline in a Monetary Union?" *Journal of Macroeconomics* 39: 348–60
- de la Porte, C. and D. Natali. 2014. "Altered Europeanisation of pension reform in the context of the great recession." *West European Politics* 37(4): 309-330.
- de la Porte,C. and E. Heins. 2015. "A New Era of European Integration?" *Comparative European Politics* 13(1): 8-28.
- Dellepiane-Avellaneda, S. and N. Hardiman. 2015. "The Politics of Fiscal Efforts in Ireland and Spain." In *The Politics of Extreme Austerity: Greece in the Eurozone Crisis*, edited by G. Karyotis and R. Gerodimos. Basingstoke: Palgrave Macmillan, pp. 198-221.
- Di Mascio, F. and A. Natalini. 2015. "Fiscal Retrenchment in Southern Europe." *Public Management Review* 17(1): 129-148.
- Di Mascio, F., D. Galli, A. Natalini,E.Ongaro and F.Stolfi. 2017. "Learning-Shaping Crises: A Longitudinal Comparison of Public Personnel Reforms in Italy, 1992-2014." *Journal of Comparative Policy Analysis* 19(2): 119-138.
- Di Mascio, F., Natalini, A., Ongaro, E. and F. Stolfi (2019) 'The influence of the European Semester on national public sector reforms under conditions of fiscal consolidation: The policy of conditionality in Italy 2011-15', *Public Policy and Administration*. Doi: <https://doi.org/10.1177/0952076718814892>

- Doray-Demers, P. and M. Foucault. 2017. "The Politics of Fiscal Rules within the European Union." *Journal of European Public Policy* 24 (6): 852–70.
- Dubin, K.A. and J. Hopkin. 2014. "The Politics of Welfare and Employment in Spain." In *The Politics of Flexicurity in Europe: Labour Market Reform in Hostile and Tough Times* edited by D. Clegg and P. Graziano. Basingstoke: Palgrave Macmillan.
- Dukelow, F. 2015. "Reinforcing the neo-liberal policy paradigm in Ireland and the impact of EU intrusion." *Comparative European Politics* 13 (1): 93–111.
- Giannetti, D., A. Pedrazzani and L. Pinto. 2017. "Party System Change in Italy: Politicising the EU and the Rise of Eccentric Parties." *South European Society & Politics* 22(1): 21-42.
- Hagemann, S., S. Hobolt, and C. Wratil. 2017. "Government Responsiveness in the European Union." *Comparative Political Studies* 50 (6): 850–876.
- Henning, C.R. 2017. *Tangled Governance: International Regime Complexity, the Troika, and the Euro Crisis*. Oxford: Oxford University Press.
- Hobolt, S.B. and J. Tilley. 2016. "The Rise of Challenger Parties in the Aftermath of the Euro Crisis." *West European Politics* 39 (5): 971–91.
- Hodson, D. 2017. "Eurozone Governance in 2016: The Italian Banking Crisis, Fiscal Flexibility and Brexit (Plus Plus Plus)." *Journal of Common Market Studies* 55 (1): 118–32.
- Hooghe, L. and G. Marks. 2009. "A Postfunctionalist Theory of European Integration: From Permissive Consensus to Constraining Dissensus." *British Journal of Political Science* 39 (1): 1–23.
- Hopkin, J. 2015. "The Troubled South: The Euro Crisis in Italy and Spain." In *The Future of the Euro*, edited by M. Blyth and M. Matthijs. Oxford: Oxford University Press, pp. 161-186.
- Howarth, D. and L. Quaglia. 2014. "The Steep Road to European Banking Union: Constructing the Single Resolution Mechanism." *Journal of Common Market Studies* 52 (SUPPL.1): 125–40.

- Hübscher, E. 2016. "The politics of fiscal consolidation revisited." *Journal of Public Policy* 36 (4): 573-601
- Jones, E. 2012. "Italy's Sovereign Debt Crisis." *Survival* 54(1): 83-110.
- Jordana, J. 2014. "Multiple Crises and Policy Dismantling in Spain: Political Strategies and Distributive Implications." *Political Studies Review* 12 (2): 224–38.
- Katsanidou, A. and S. Otjes. 2015. "How the European Debt Crisis Reshaped National Political Space: The Case of Greece." *European Union Politics* 17 (2): 262–84.
- Kickert, W. and E. Ongaro. 2019. "Influence of the EU (and the IMF) on domestic cutback management: A nine-country comparative analysis," *Public Management Review*. Doi: <https://doi.org/10.1080/14719037.2019.1630140>
- Kickert, W. and T. Ysa. 2014. "New Development: How the Spanish Government Responded to the Global Economic, Banking and Fiscal Crisis." *Public Money & Management* 34 (69): 453-457.
- Kickert, W. and T. Randma-Liiv. 2017. "The Politics of Cutback Management in Thirteen European Countries." *Public Management Review* 19(2): 175-193.
- Ladi, S. 2014. "Austerity politics and administrative reform." *Comparative European Politics* 12(2): 184-208.
- Ladi, S. and P. Graziano. 2014. "Welfare State Reform in Light of the Eurozone Crisis." In *Europeanization and European Integration*, edited by R. Coman, T. Kostera and L. Tomini. Basingstoke, Palgrave Macmillan, pp. 108-126.
- León, M., E. Pavolini, and A. Guillén. 2015. "Welfare Rescaling in Italy and Spain." *European Journal of Social Security* 17 (2): 182-201.
- Lampropoulou, M. 2018. "Policy responses to the Eurozone crisis" *Public Policy and Administration*.
- Mariotto C. 2018. "Negotiating implementation of EU fiscal governance." *Journal of European Integration*

- Morlino, L. and F. Raniolo. 2017. *The Impact of the Economic Crisis on South European Democracies*. Basingstoke: Palgrave Macmillan.
- Moschella, M. 2017. "Italy and the Fiscal Compact: Why Does a Country Commit to Permanent Austerity?" *Italian Political Science Review* 47(2): 205-225.
- Olmastroni, F. and A. Pellegatta. 2018. "A Mass-Elite Comparison of Mutual Perceptions and Support for the European Union in Germany and Italy." *Contemporary Italian Politics* 10(1): 56-75.
- Ongaro, E. 2009. *Public management reform and modernization: Trajectories of administrative change in Italy, France, Greece, Portugal and Spain*. Cheltenham, UK and Northampton, MA: Elgar.
- Ongaro, E. 2014. "The relationship between the new European governance emerging from the fiscal crisis and administrative reforms: Qualitatively different, quantitatively different, or nothing new? A plea for a research agenda." *Halduskultur – Administrative Culture* 15(1): 10-20.
- Ongaro, E., Ferre', F. and G. Fattore. 2015. The fiscal crisis in the health sector. Patterns of cutback management across Europe. *Health Policy*, 119(7): 954-963.
- Ongaro, Edoardo and Walter Kickert (2019) 'EU-driven Public Sector Reforms', *Public Policy and Administration*. Doi: <https://doi.org/10.1177/0952076719827624>
- Orriols, L. and G. Cordero. 2016. "The Breakdown of the Spanish Two-Party System." *South European Society & Politics* 21(4): 469-492.
- Otjes, S. and A. Katsanidou. 2017. "EU integration as a super issue after the Eurocrisis." *European Journal of Political Research* 56: 301–319.
- Perez, S.A., and M. Matsaganis. 2018. "The Political Economy of Austerity in Southern Europe." *New Political Economy* 23 (2): 192–207
- Picot, G. and A. Tassinari. 2015. "Politics in a Transformed Labor Market: Renzi's Labor Market Reform'." In *Italian Politics 2014* edited by C. Hanretty and S. Profeti. Oxford and New York: Berghahn Books, pp. 121–140.

- Picot, G. and A. Tassinari. 2017. "Labour Market Reforms under Austerity in Italy and Spain." *Socio-Economic Review* 15(2): 461-482.
- Przeworski, A. and H. Teune. 1970. *The Logic of Comparative Social Inquiry*. New York: Wiley.
- Putnam, R.D. 1988. "Diplomacy Games: The Logic of Two-Level Game." *International Organization* 42 (3): 427–60
- Quaglia, L. and S. Royo. 2015. "Banks and the political economy of the sovereign debt crisis in Italy and Spain" *Review of International Political Economy* 22: 485-507.
- Quaglia, L. and A. Spendzharova. 2017. "The Conundrum of Solving 'Too Big to Fail' in the European Union." *Journal of Common Market Studies* 55 (5): 1110–26.
- Randma-Liiv, T. and W. Kickert. 2017. "The Impact of the Fiscal Crisis on Public Administration Reforms." *Journal of Comparative Policy Analysis* 19(2): 155-172.
- Rathbun, B.C. 2008. "Interviewing and Qualitative Field Methods." In *The Oxford Handbook of Political Methodology*, edited by J.M. Box-Steffensmeier, H.E. Brady, and D. Collier. Oxford: Oxford University Press.
- Sacchi, S. 2015. "Conditionality by other means." *Comparative European Politics* 13 (1): 77–92.
- Sacchi, S. and J. Roh. 2016. "Financial Crisis and Its Impact on Welfare in Italy and Korea." *Journal of European Social Policy* 26(4): 358-373.
- Savi, R. and T. Randma-Liiv. 2015. "Decision-making in time of crisis." *International Review of Administrative Sciences* 8 (3): 479–497.
- Sotiropoulos, D. 2015. "Southern European Governments and Public Bureaucracies in the Context of the Economic Crisis." *European Journal of Social Security* 17(2): 226-245.
- Stolfi, F. 2013. "The Monti Government and the European Union." In *Italian Politics 2012*, edited by Claudio Radaelli and Aldo DiVirgilio, 217-236. New York: Berghahn Books.

- Theodoropoulou, S. 2015. “National Social and Labour Market Policy Reforms in the Shadow of EU Bail-out Conditionality” *Comparative European Politics* 13 (1): 29–55.
- Verdun, A. and J. Zeitlin. 2018. “Introduction: the European Semester as a new architecture of EU socioeconomic governance in theory and practice.” *Journal of European Public Policy* 25 (2):137-148.
- Vidal, G. 2018. “The Rise of New Parties in Spain in Times of Crisis.” *West European Politics* 41(2): 261-286.
- Zeitlin, J. 2016. “EU Experimentalist Governance in Times of Crisis.” *West European Politics* 39 (5): 1073–94.
- Zeitlin, J. and B. Vanhercke. 2018. “Socializing the European Semester.” *Journal of European Public Policy* 25 (2): 149–174.

¹De la Porte and Natali 2014 distinguish “domestic vulnerability” from “EU vulnerability”, namely between the Member States’ own vulnerability to market pressures and the vulnerability of the EU as a whole respectively. Given the size of the Italian and Spanish economies, these two types of vulnerability coincide for these two countries, given the repercussions on the stability of the Eurozone, if not of the EU itself, if either country were to go bankrupt. Vulnerability will be operationalized in terms of the interest rate spread between Italian and Spanish government bonds and German ones (De Grauwe and Ji 2014).

TABLES

Table 1: Cabinets in Italy and Spain (2008-2016)

ITALY	SPAIN
<p style="text-align: center;">Berlusconi Government (May 2008-November 2011)</p> <p>Coalition of centre-right parties; Unidimensional structure of political competition but increasing opposition to the EU by the Northern League</p>	<p style="text-align: center;">Zapatero Government (April 2008-December 2011)</p> <p>Centre-left Single Party Government; Unidimensional structure of political competition</p>
<p style="text-align: center;">Monti Government (November 2011-December 2012)</p> <p>Technical government supported by a grand coalition of centre-right and centre-left parties; Dissatisfaction with mainstream parties immediately translated into a challenger party (Five Star Movement)</p>	<p style="text-align: center;">Rajoy Government (December 2011-December 2015)</p> <p>Centre-right Single Party Government; Dissatisfaction with mainstream parties translated into social protest and non-conventional participation (Indignados movement); late institutionalization of protest through challenger parties (Podemos and Ciudadanos) since 2014</p>
<p style="text-align: center;">Letta Government (April 2013-February 2014)</p> <p>Hung parliament as the Five Star Movement surged at the 2013 general elections; Grand coalition of centre-left and centre-right parties</p>	<p style="text-align: center;">Rajoy Government (December 2015-October 2016)</p> <p>Hung parliament as Podemos and Ciudadanos surged at the 2015 general elections; Caretaker government</p>
<p style="text-align: center;">Renzi Government (February 2014-December 2016)</p> <p>Surplus majority coalition of centre-left parties; Bidimensional structure of political competition with increasing importance of the anti-/pro-EU attitude</p>	<p style="text-align: center;">Rajoy Government (October 2016-current)</p> <p>Centre-right Single Party Minority Government; Unidimensional structure of political competition</p>

Table 2. Channels of EU influence in Italy and Spain (2008-2016)

Italy	CHANNEL	Spain
Deficit Reduction (2008-2016); Labour Market Reform (2014)	Formal procedures	Deficit Reduction (2008-2016); Fiscal Framework (2013); Pension Reform (2013); Administrative Reform (2013)
Deficit Reduction (2011-2012); Fiscal Framework (2012); Labour Market Reform (2012)	Conditionality	Deficit Reduction (2011-2014); Fiscal Framework (2011); Labour Market Reform (2012)
Deficit Reduction (late 2011); Appointment of a technical government (late 2011); Pension Reform (2011)	Backroom diplomacy	Deficit reduction (2010-2012)

Table 3. The impact of EU influence on fiscal consolidation and public sector reforms in Italy and Spain (2008-2016)

Italy	TARGET	Spain
Focused on Revenue Increase	Deficit Reduction	Focused on Spending Reduction
Deregulation of dismissal protection since 2012; progressive measures under the Renzi government	Labour Market Reform	Deregulation of dismissal protection launched in 2010 and deepened in 2012
Increase in the minimum age of retirement; Adjustment to increase in life expectancy	Pension Reform	Increase in the minimum age of retirement; Adjustment to increase in life expectancy
Limited progress	Liberalization of Services	Limited progress
Balanced budget rule; Independent Fiscal Council	Fiscal Framework	Balanced budget rule; Independent Fiscal Council
Cuts to public employment;	Public Administration Reform	Cuts to public employment; Reorganization focused on efficiency gains

APPENDIX

Semi-structured interviews were conducted mostly face-to-face in the interviewees' office and occasionally by phone. In order to limit informant bias and improve construct validity, interviews were conducted with informants who viewed the workings of EU channels of influence from diverse perspectives and backgrounds. We decided on an approach using open-ended questions that allowed the respondents to fully articulate their answers (Aberbach & Rockman 2002). The flexibility of this approach fits our exploratory research that aimed to reconstruct a set of events, in particular the hidden elements of political actions that were not clear from an analysis of documentary evidence (Rathbun 2008). Given the sensitivity of the issues discussed, anonymity was assured to interviewees. Most of them preferred us to rely on handwritten notes as they felt uncomfortable with us recording interviews.

List of interviews conducted for the Italian case:

#	Position	Institution	Date	Mode	Length
1.	Member	Parliamentary Budget Office	06-05-2016	face to face	67'
2.	Policy advisor	Ministry of Finance (under the Renzi Government)	06-06-2016	face to face	42'
3.	EU Official	Troika	22-06-2016	phone	28'
4.	Policy Advisor	Ministry of Finance (under the Monti government)	17-07-2016	face to face	54'
5.	Member	Parliamentary Budget Office	12-05-2017	face to face	61'
6.	EU Official	Troika	22-05-2017	phone	25'
7.	Former Delegate in Italy Rome	European Commission	23-05-2017	face to face	48'
8.	Policy Advisor	Ministry of Finance (under the Renzi government)	25-05-2017	face to face	47'

List of interviews conducted for the Spanish case

#	Position	Institution	Date	Mode	Length
1.	Executive Director	International Monetary Fund	02-05-2016	phone	74'
2.	State Secretary for Economy	Ministry of Economy and Competitiveness (under Rajoy governments)	02-05-2016	phone	74'
3.	Head of Unit	European Commission, DG for Financial Stability, Financial Services and Capital Markets Union	19-05-2016	phone	33'
4.	Head of Cabinet	European Commissioner for Economic and Monetary Affairs and the Euro	06-06-2016	face to face	44'
5.	Speaker	Member of the DG Economic and Financial Affairs	06-06-2016	face to face	44'

6.	Member of Executive Board	European Central Bank	16-06-2016	face to face	43'
7.	State Secretary for Economy	Ministry of Economy and Finance (under Zapatero government)	26-09-2016	face to face	24'