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The Political Economy of Italy in the EMU: What Went Wrong?

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Abstract. Although Italy was amongst the most enthusiastic founding members of the European Economic Community in 1957, the Italian capacity to respect the imperatives of European integration could not, and, still, cannot, be given for granted, as the recent sovereign debt crisis demonstrates. Apart from the many structural inconsistencies that persist not only in the economic, but also in the political and social organization of the country, also the public debate is sometimes characterised by a tendency to blame the process of Europeanisation for the less palatable decisions taken by the national institutions. This article addresses the sub-national, national and supranational dimensions of the process of Italian Europeanisation focusing in particular on the role of domestic socio-economic actors in influencing monetary policy decision making processes. The article is based on field research conducted by the author both in Italy and Brussels. The main object of this research effort was to analyse to what extent the outcomes of the process of European monetary integration have been influenced by domestic politics and by domestic economic interest groups in Italy with the final aim of assessing the impact of Italian entry into the EMU and especially its future within it. Thus, at the core of this research lies the following question: *What is the role of domestic politics and domestic interest groups in monetary policy-making?* The theoretical starting point of this interpretation of the process of European monetary integration is represented by an integrated domestic-foreign policy focusing on the role of economic interest groups in defining national exchange rate and monetary policy decisions. It is not here the place to discuss the different theories explaining the process of European integration and, more specifically, of the issue of European monetary integration. Here it will simply be underlined that, to explain foreign economic policy choices, policy outcomes need to be linked to domestic politics.
Keywords. EMU, Eurozone crisis, Italy
JEL. F45, F31, F51.

1. Introduction: Italy and the crisis of the Euro-Zone

From the second half of 2011, Italy experienced an increased pressure on its sovereign debt from financial markets. From July to November 2011 the spread between the Italian BTPs (Italian 10 year treasury bills) and the German Bund, a common measure of such pressure, surpassed 400 basis points on many occasions. Although it was generally felt that the situation was extremely serious, this indicator tends to maximise the effects of the pressure on interest rates as it is strongly influenced by the reduction of the interest rates paid on the Bund, which, given the instability of the global economy, were selected by investors as a safe heaven.

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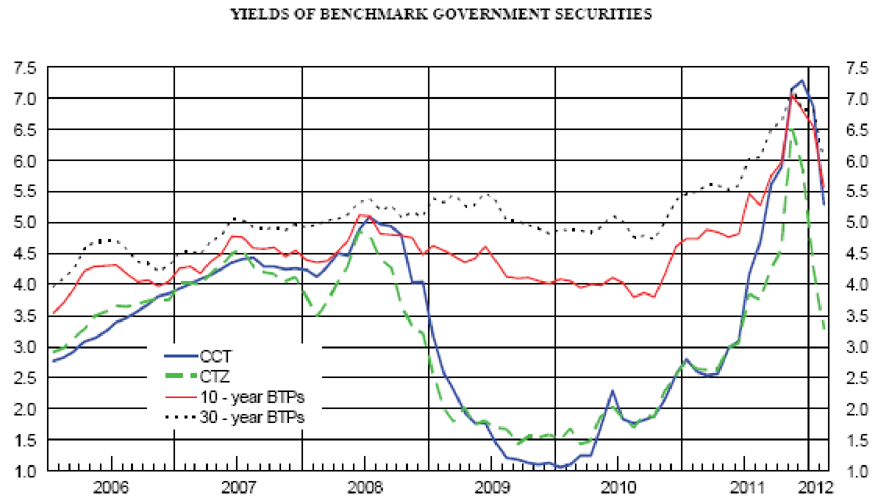
In the same period, the interest rates of Italian long term debt emissions increased steadily to reach quota 6.99% in November 2011. However, the Bank of Italy noticed how the fiscal position had not yet become unsustainable. First of all, during the crisis Italian debt did not remain unsold[i] and the allocation of Italian Treasury bills happened regularly.

Moreover, in June 2011 Italian public debt was around 1900 billion Euros. Only 39.2% was held by foreign investors, which is a relatively small percentage as compared to other European countries. Italian families held the biggest part of the debt, with residents holding around 14%, followed by banks, insurance companies and funds.[ii]The composition of debt ownership did not change substantially in the course of the crisis apart from an increase in the quota held by Italian banks.[iii]

Finally, some the pressure on Italian debt needs to be inserted in the context of a liquidity shortage which brought many European investors to sell assets.



GRAPH 1. *Yields of Benchmark Government Securities-Italy*
Source: Bank of Italy 2011

TABLE 1. *Interest Rates-Italy Feb. 2011-Feb.2012*

Interest rates

Period		Official Eurosystem interest rates (1)			Government securities (2)			Banks' interest rates (3)		
		Deposit facility	Marginal lending facilities	Main refinancing operations	BOT	BTP	CCT	Deposits	Loans: Households	Loans: Non-financial corporations
2011	February	0.25	1.75	1.00	1.57	4.69	2.49	0.71	4.33	3.24
	March	0.25	1.75	1.00	1.63	4.78	2.33	0.75	4.32	3.25
	April	0.50	2.00	1.25	1.82	4.76	2.35	0.78	4.36	3.35
	May	0.50	2.00	1.25	1.85	4.70	2.70	0.86	4.41	3.42
	June	0.50	2.00	1.25	2.06	4.78	2.94	0.88	4.43	3.51
	July	0.75	2.25	1.50	2.97	5.38	3.98	0.91	4.50	3.68
	August	0.75	2.25	1.50	2.52	5.30	4.55	0.94	4.54	3.75
	September	0.75	2.25	1.50	3.10	5.68	5.36	0.96	4.54	3.79
	October	0.75	2.25	1.50	3.33	5.92	5.78	1.00	4.55	3.88
	November	0.50	2.00	1.25	6.40	6.99	7.44	1.05	4.56	3.94
	December	0.25	1.75	1.00	4.45	6.59	8.91	1.08	4.51	4.04
2012	January	0.25	1.75	1.00	2.24	6.22	6.47	1.16	4.50	4.05
	February	0.25	1.75	1.00	1.64	5.24	4.61	-	-	-

(1) End period data.
(2) BOT interest rates are calculated in the auctions held in the month indicated; for other Government securities yields to maturity on Borsa Italiana (MOT). The data for the last months are provisional and could be revised.
(3) Harmonized statistics of the ESCB: main interest rates on outstanding amounts.

Source: Bank of Italy 2011

Despite some evidence to the contrary, there was a widespread belief that Italy was on the verge of default. This was influenced by the extent that the political equilibrium of the country, resting on the centre-right government of Silvio Berlusconi, was shattered to the point of no-return. Amid fears of a fiscal melt down, Mario Monti, a technocrat with great experience both of the EU and of financial markets, was able to form an unelected government with the only ostensible aim of calming down the markets and allowing the fiscal crisis to ease.

What was the price that the markets asked in exchange for a truce on their attacks to the Italian sovereign debt? There is no doubt that much of Monti's success in calming down the markets was due to a decree on market liberalisation. The Italian capitalist system has long been known for being extremely closed to foreign investment. The system allowed Italian capital to keep control of the Italian economy. It revolved around a web of cross-shareholdings that allowed the financial and corporate elite to sit on each other's boards and wield influence over several companies often through only a small stake.

Mario Monti identified the dismantling of this so called Italian 'Salotto Buono'(i.e. the Italian establishment) as the price to pay to financial markets. Indeed in Mr Monti's 'Save Italy' liberalisation decreeit was made clear that from 25thApril, 2012 it would be illegal to hold a board seat in more than one financial institution operating in the same market. The aim was clearly that of opening to foreign financial capital Italy's triumvirate of boardroom power, UniCredit, Generali and Mediobanca, where no less than six men sit on at least two out of the three boards.[iv]

Moreover, these companies were linked by cross-shareholdings. Mediobanca owned 13 per cent of Generali and 7 per cent of UniCredit via a structured finance deal. UniCredit owned 9 per cent of Mediobanca. It is worth noticing that through this system, Mediobanca, the productive investment powerhouse of Italy, the mother of Italian family capitalism, influenced strategic choices at Generali, Europe's third-largest insurer by assets. By eliminating such a link, Italian capitalism was out for sale to the same financial markets that attacked its sovereign debt.

Mr Monti's decision was very controversial in Italy, where discussion opened on whether there was a loophole in the decree and if article 36 really meant what it appeared to say. As one senior board member of an Italian bank said: 'If you have one or two of those seats, you really don't want to give them up.'[v]

But it seems clear that Monti was determined to put Italian relationship capitalism to an end and satisfy foreign investors' long term desire to get their feet in the door by opening up a system that has traditionally been impenetrable to all but powerful insiders.

As Monti said at a press conference: 'It is natural and dutiful for the government to be open to a dialogue with parliament, 'but some changes to the liberalisation decree did not 'cannot and will not be welcomed'.[vi]

To be sure, financial markets welcomed a similar approach. Riccardo Barbieri, of Mizuho International, praised Mr Monti's government for its accomplishments but said the vote on the liberalisation package and the labour reform negotiations were 'critical'.

'Deregulation is necessary and will challenge the government's ability to win concessions even from the strongest lobbies and to change the structure of the economy,' he said.[vii]

What prompted the run on the Italian sovereign debt? Was deregulation and liberalisation the only way by which the Italian government could address this problem?

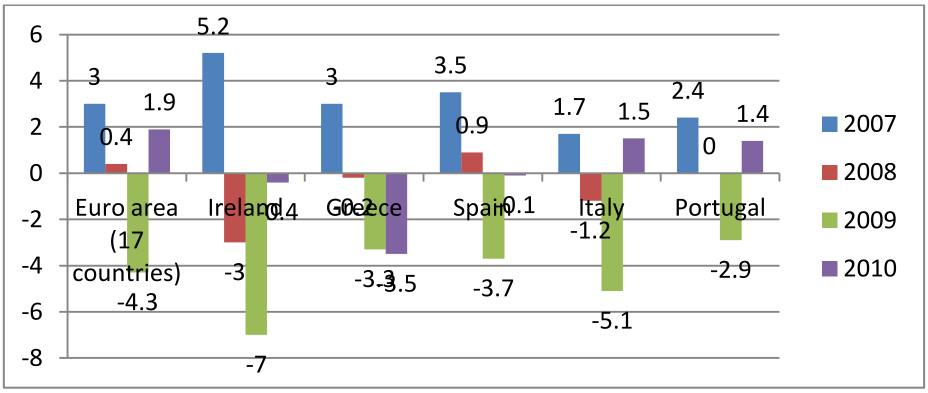
This article will answer these questions by looking at the history of Italian commitment of the EMU with the final aim to assess what went wrong.

2. Structural imbalances of the EMU: internal devaluation as the only solution

Much of the blame for the sovereign debt crisis has been put on the dire situation of the PIIGS fiscal stance. Although it cannot be denied that the countries considered were not enjoying a healthy budgetary situation, it must be noted that the policy of fiscal stimulus to combat the crisis came at a high cost for the fiscal position of many other countries. For example, the newly elected Obama administration introduced a stimulus package of $ 800 billion, bringing the budgetary deficit to 10 per cent of GDP in 2009. A similar figure was envisaged for the same year in Japan, while in the UK the deficit to GDP figure was almost 13 per cent. In the eurozone, the deficit to GDP was on average only 6 per cent in 2010, whereas in the mid1990s it had reached more than 7%[viii]. The situation was of course different in the different countries of the eurozone. However, with respect to the case of the PIIGS, two points must be stressed.

First, some of the countries which have since been affected by the most serious wave of attacks to their sovereign debt were by no means performing so badly in terms of deficit to GDP in the course of the crisis. In 2010, when the attacks started, Greece had a deficit to GDP of 10.3%, only 4.3% higher than the eurozone average which was 6% at the time. Portugal and Spain with 9.8% and 9.3% respectively were just around 3.8% and 3.3% higher than the eurozoneaverage[ix]. Italy had actually been doing quite well in the course of the crisis, better than the average of the eurozone, with a deficit to GDP of only 4.6% in 2010, which had even declined from 5.4% in 2009. Of course, commentators then blame the Italiansfor having an outrageous debt to GDP ratio. However, it is worth noting that in 1995 this ratio was 121.5% against an average of 72.5% in the rest of the future eurozone, whereas by 2010 the difference between the Italian performance and the average of the eurozone had actually decreased from 49% in 1995, to 34%[x]. Moreover, in 2010 Spain had a debt to GDP ratio of 61.2% much below the eurozone average of 85.2%, and also Ireland and Portugal were not doing that bad with figures of 92.5%and 93.3% respectively[xi].

Finally, similar performances of the deficit and debt to GPD ratio must be seen in the context of spectacularly declining levels of GDP which by definition, if only for mathematical reasons, increase their values. Between 2007 and 2009, Ireland lost 12.2% of its real GDP, Greece 6.5%, Spain 7.2%, Italy 6.8% and Portugal 5.3% (Graph 2)



GRAPH 2. *Real GDP loss 2007-2010*
Source: EUROSTAT elaboration of the author

In an effort to identify the relation between the global financial crisis and the crisis of the eurozone, it is important to ask, along with the relevant literature, two questions[xii]:

First, are the larger spreads recorded in the course of the crisis a consequence of larger fiscal deficits and debt or do they show a change in the attitude of the markets towards the pricing of government credit risk?

Second, to what extent did the global financial crisis modify the attitude of the markets towards credit risk in the direction of more risk aversion?

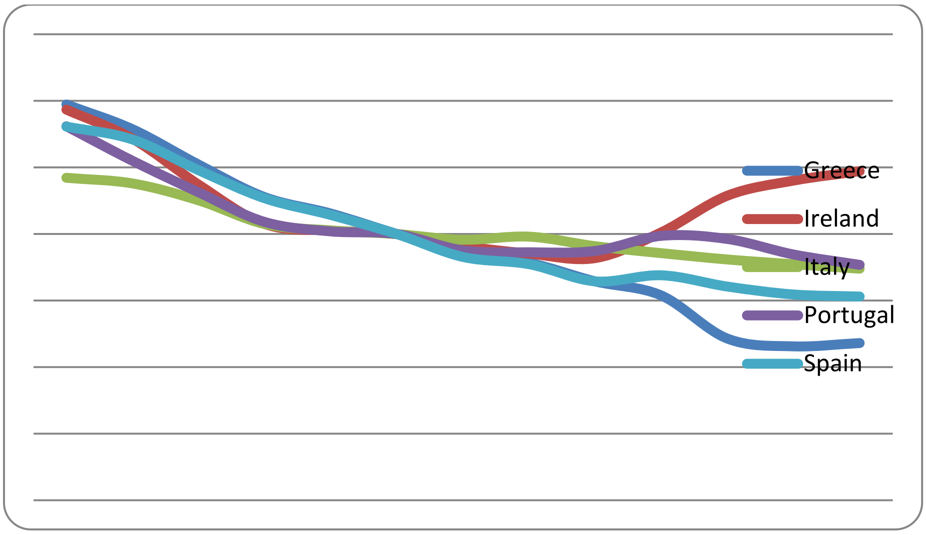
The empirical results of a study conducted by the ECB shows that markets penalised fiscal imbalances much more strongly after the collapse of Lehman Brothers in September 2008, to the extent that coefficients for deficit differentials were 3-4 times higher and for debt differentials 7-8 times higher during the crisis period than earlier (Manganelli et al 2009). So, to answer the first question, the markets clearly changed their attitude towards pricing of government credit risk in the course of the global financial crisis and in its aftermath. But why did they do that? First the study underlines how there was a significant increase in bond spreads due to a general increase of risk aversion. This makes a lot of sense if we think that over the course of the crisis, the collapse of the stock exchange and of the housing market together with a general uncertainty about exposure to very risky assets of most of the banking system made it imperative to look for safe havens to invest in. We have already underlined how the price of commodities such as gold and oil went up as a consequence of the general instability of other forms of investment, and how this lead to a commodity price bubble which is considered in the literature as the fourth phase in the development of the crisis (Orlowski 2008). Also government bonds in the US and, after the start of the crisis, Germany, the benchmark in the euro-denominated bond market, assumed a safe-haven investment status. Furthermore, not only were investors/markets generally more risk averse, but they were also penalizing fiscal imbalances much more strongly than before September 2008, as demonstrated by the ECB study. These two factors account for much of the spread increase for EU country government bonds relative to German or US treasury benchmarks (Manganelli et al 2009).

It is indeed remarkable that US government bonds, the country where the crisis had started and which was experiencing huge fiscal imbalances, instead of becoming more risky were unanimously considered by the markets as a safe haven in which to invest in a period of instability.

The case of Germany, however, is less puzzling. In the whole process of European monetary integration, from the establishment of the exchange rate mechanism of the European Monetary System onwards, Germany had been the '1' country of the 'n-1' problem, i.e., the country with the strongest currency which could, because of the technical characteristics of the fixed exchange rate arrangement, define the monetary policy for all the members of the currency agreement (De Grauwe 1996:27). More specifically, the 'n-1' problem entails that in a fixed exchange rate systemthere are only 'n-1' independent exchange rates, and therefore, while 'n-1' countries have to use their monetary policy so as to keep their exchange rate fixed, there is always'1' country, the one with the strongest currency, which is free to set its monetary policy independently of exchange rate constraints. Moreover, by definition, the '1' country is the one with the strictest, more credible, anti-inflationary monetary policy which allows its currency to be stronger than the currencies of the other members of the Union. This, however, has evident consequences for the competitiveness of the 'n-1' countries, which by definition experience higher inflation rates and therefore progressively lose competitiveness up to the point at which their exchange rate becomes unsustainable and the markets can successfully speculate against their currencies.

Although, clearly, in the economic and monetary union there is only one monetary policy and no exchange rates, first the global financial crisis and then the economic crisis made it clear to what extent the asymmetries and the 'n-1' problems that had already affected the ERM of the EMS persisted, and were actually much more serious, in the EMU.

Indeed, for the 'n-1' countries joining the EMU meant fixing the exchange rate at a higher value than it would have otherwise been, and this is particularly true for the least competitive countries whose currencies tended to devalue more often before the establishment of the EMU, i.e., the PIIGS countries. On the other hand, the '1' country, Germany, joined the EMU enjoying a devaluation of its exchange rate which, together with the impossibility of any competitive devaluations by the other members of the EMU, progressively increased its competitiveness. This trend is clearly visible looking at the power purchasing parity real exchange rate (RER)[13] of the PIIGS in relation to Germany based on the average consumer price index from 2000-2012 (Graph 3).



GRAPH 3. *PIIGS Real Exchange Rates: 2000-2012*
Source: IMF, WEO-elaboration of the author

What is important to underline here is that this is a structural characteristic of the EMU which was inherited from the previous exchange system but was made more serious by the fact that in the EMU there is no possibility to re-gain competitiveness through devaluation.

Thus, from the start of the EMU, Germany enjoyed a structural bonus of competitiveness which increased progressively, as, indeed, had been predicted by many EPE scholars (Frieden 1991,1994,1998; Eichengreen and Frieden 1994; Moravcsick 1998). Of course, exchange rate devaluation is considered in the economic literature as a very bad way to regain competitiveness. Much emphasis was therefore placed on what is normally referred to as 'internal devaluation', or 'supply side economics' which basically means reducing the costs of production by increasing productivity and/or reducing labour costs. Indeed, the EU approached and still approaches the whole question of growth and employment by relying significantly on labour market flexibility, the rationale of which is often neo-functionally linked to the establishment of EMU. Furthermore, the implementation itself of flexible labour market policies was made possible by the strengthening of the bargaining power of employers' organisations, which was reflected in the institutionalisation at the European level of the neo-liberal economic paradigm focusing on the implementation of strict monetary and fiscal policies.

3. The neo-functionalist case linking asymmetric shocks to labour market flexibility within the EMU

If we consider the Global financial crisis as an asymmetric shock it is easy to identify the neo-functionalist case leading from the EMU crisis to structural reform of the labour markets. Asymmetric shocks are defined as economic shocks (both demand side and supply side ones) which hit different countries or regions of a currency union area in distinct ways. These are likely to happen within the Euro area as this does not meet all the requirements of an Optimum Currency Area.[xiii] By definition, autonomous monetary policy and exchange rate policies are not available to react to idiosyncratic shocks in a currency union. At the same time, common monetary and exchange rate policies should be used with caution since they can have mixed results if the other members of the Union are simultaneously experiencing a business cycle operating in the opposite direction. Thus, economic theory leaves few options: fiscal policy, labour mobility and labour flexibility.

Indeed, a country could react to an asymmetric shock by using national fiscal policy both as a counter-cyclical tool, through the action of automatic stabilisers, and in the form of fiscal transfers to solve more long-term economic disparities (as in the case of the Italian *Mezzogiorno*). However, in the special kind of monetary union analysed in this chapter, the Maastricht criteria and to an even greater extent the requirements of the Stability Pact substantially limit the ability of Member States to resort to national fiscal policy in order to tackle asymmetric shocks.

Alternatively, some authors suggest that the redistributive and stabilising functions of fiscal policy be performed at the European level. Proposals on this matter range from an increase in the size of the European budget to the pooling of national fiscal policies and the establishment of a Common fiscal body, which would act as a counterbalance to the ECB (e.g. Obstfeld and Peri 1998). The feasibility of similar proposals looks at least dubious in the light of the difficulties that the EU Member States encounter in reaching agreement on the much less challenging task of tax harmonisation (Overbeek 2000). Moreover, the discussion of fiscal policy inevitably raises more general concerns about the loss of national sovereignty. Overall, the EU Member States are unable to reach agreement on the creation of a common fiscal policy as well as finding some way of increasing the size of the EU budget, thus introducing a stabilisation function.

Given the difficulties in using national fiscal policy to tackle asymmetric shocks, and the lack of any substantial fiscal power at the European level, economists suggest the option of greater labour mobility. The EU does indeed provide an institutional framework within which labour mobility can be enhanced. The Treaty's articles on the free movement of workers, the Single Market programme, and recent provisions on migration are all directed toward this objective. However, economic analyses show little evidence of mass migration in response to asymmetric shocks in the EU (in contrast, in some respects, to the US) (Obstfeld and Peri 1998). Indeed, few European policy makers would seriously endorse temporary mass migration as a credible way of reacting to national economic strains, for obvious political as well as social considerations.

There thus remains only one policy option for national policy makers who wish to tackle the problems arising from asymmetric shocks: increasing the flexibility of labour markets so that 'regions or states affected by adverse shocks can recover by cutting wages, reducing relative prices and taking market shares from the others'

(Blanchard 1998: 249). Not only this, but since reform of the labour market is clearly a structural intervention, it will also help to eliminate the structural component of unemployment, in addition to the cyclical one, if indeed it is still possible to distinguish between the two (Artis 1998).

In fact, as analysed above, the employment rhetoric and strategy officially adopted by EU institutions in the last few years clearly shows that the European Union has chosen to give priority to labour flexibility as the favoured means to tackle the problem of unemployment in Europe.

However, this is not an automatic necessity stemming from the existence of a neo-functional relation between the implementation of the Maastricht path towards EMU and labour market flexibility but, as clearly specified above, the consequence of the political decisions taken, mostly in an intergovernmental fashion, by the Member States within the context of the European Union institutions and procedures. These decisions were: first and foremost to establish a currency union constrained by the fiscal straightjacket enshrined in the Maastricht criteria and in the SGP (especially the first version); and secondly the conclusion that the only credible way to react to asymmetric shocks and increase employment was not to rely on fiscal stimulation or even fiscal co-ordination, but merely on supply side measures like labour market flexibility. In other words, the entirely political decision to constrain national fiscal policy within EMU and the even more political decision to keep European fiscal policy in a state of infancy, has led to an EES which can only rely on the flexibility of labour markets.

Whether these labour reforms represent the solution to the problem of unemployment is indeed a different issue. As Esping-Andersen (1999) reminds us, there is a considerable gap between the widely accepted theoretical claims that deregulation will create jobs and the evidence that rigidities seem to matter only selectively. Moreover, similar labour rigidities must be understood in the context of the societal structures where they exist. This is why we now turn our attention to the specific case of Italy and the power relation between socio-economic sectors with respect to the flexibility of labour markets.

4. Labour market flexibility and socio-economic sectors: the case of Italy

The expression ‘flexibility of labour markets as used by the scholars of industrial relations (Rhodes 1997) refers to three forms of flexibility:

- Internal (or functional) flexibility in the work place;
- External (or numerical) flexibility vis-à-vis the wider labour market
- Greater pay flexibility at local levels

Categorising the level of flexibility/rigidity of European labour markets along the dimensions of internal and external flexibility, we can distinguish what in the literature is referred to as the ‘southern cluster’ (Rhodes 1997:10-11). This is characterised by a remarkable shift from very low levels of both external and internal flexibility of the ‘legal’ or ‘licit’ labour markets in the 1970s to a much higher level of flexibility in the 1990s. At the same time these economies (first and foremost Italy and Spain) saw the growth of ‘illicit’ labour markets and a shift from labour exporting to labour importing.

This process took place amid heated struggles between socio-economic groups that inevitably changed the balance of power between them. In this context, the EU issues in general and EMU in particular provided the excuse to shift the power battle from the national to the European level. This shift was by no means neutral. In the move from the national to the international level, some groups acquired more strength and cohesion. Others lost a great deal of their bargaining power for reasons ranging from a decreased organisational or representative capacity to a structural bias of the EU institutional setting in favour of certain societal interests. This game of transnationalisation is indeed played much more easily by the employers' organizations than by the unions, given the many cleavages within the European working class reflected in the cumbersome functioning of the European Trade Unions Confederation (ETUC) (Talani 2000; Ryner and Schulten 2003). Here it is underlined how, by shifting the struggle around labour flexibility in Italy and Spain between employers and employees from the national to the European level, the relative power positions between the two groups also changed, which made it easier to introduce neo-liberal labour market reforms.

Whether, though, these labour reforms represent the solution to the problem of unemployment in Mediterranean countries is indeed a different issue.

The so-called Mediterranean model is often characterised as a familial one, i.e. one based on the assumption that the family male is the only bread winner (Esping-Andersen 1999). This would explain the exceedingly high levels of female and youth unemployment that are not inconsistent with a high level of labour protection and a low level of social protection. The family is the locus of social protection, and wife and children remain dependent on the income of the father up to a very late age. The protection of the job of the latter thus becomes of fundamental importance for the entire society. This model differs substantially from the liberal model, prevailing in Anglo-Saxon countries, where in the trade off between flexibility and exclusion there is a tendency towards the former, along with all that this implies in terms of decreasing equality (Esping-Andersen 1999). And indeed in Anglo-Saxon countries a high degree of labour market flexibility produces high levels of employment at the expense of a growing wage polarisation between unskilled and skilled workers (Jessop & Becker 2003).

It could be claimed that in the era of globalisation the Anglo-Saxon model is the only viable one in view of the competitive pressures stemming from lower labour costs in less developed countries. Indeed, that is the basic argument used by the supporters of flexibility, particularly within employers' organisations. But apart from the fact that the impact of globalisation on employment is far from clear (Overbeek 2003), the price in terms of increasing inequality might not be worth paying in countries where the societal setting is opposed to the Anglo-Saxon one. This, however, is not the place to address the many complex issues influencing the future of employment in a globalising world. Therefore we now turn to the analysis of the Italian case.

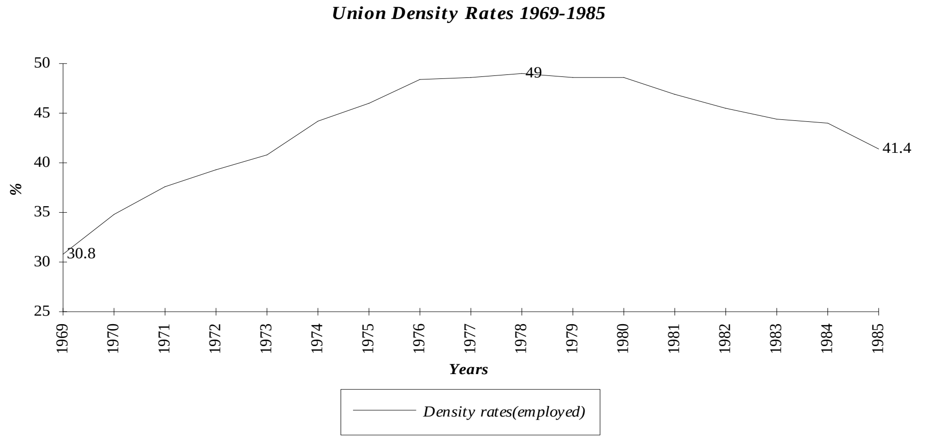
In Italy, European issues and those related to the process of European monetary integration in particular were consistently used by the leading socio-economic groups (particularly big industry) to reduce the level of labour protection and increase the flexibility of labour markets (Talani 2000).

To analyse this in more detail the next section will first deal with the decrease in labour protection legislation in relation to Italian entry into the exchange rate mechanism of the EMS. Subsequently we will address labour market flexibility as a consequence of EMU.

4.1. The EMS and the struggle over the Scala Mobile

It is generally agreed that the first relaxation in Italian labour protection legislation was represented by the abolition of the Italian wage indexation mechanism known as the *Scala Mobile*. This was made possible by commitment to the EMS, with all that it implied in terms of strict anti-inflationary policies. The abolition of the *Scala Mobile* was a consequence of the new dominant position of Italian capitalist groups and also served to enhance their position.

The ‘hot autumn’ of 1969 marked the beginning of the ‘era of union centrality’ (Lange et al 1982:97; Giugni 1981:341; Regini 1981). This was an era in which Italian economic policy was characterised by prevailing concerns for the maintenance of the purchasing power of wages, the institutionalisation of workers’ rights and the leading role played by the trade unions and their political counterparts in Italian socio-economic policy making. The growing strength of trade unions during this period is reflected clearly in the ascending slope of its membership parabola, the density rates on which increased constantly from 1969 onwards before reaching their peak in 1978 with 49% of the total employed population, an 18.2% increase with respect to the 1969 figure (see Graph 4).



GRAPH 4. *Density of union membership in Italy 1969-1985*
Source: Centro Studi Economici Sociali e Sindacali, (CESOS), Le relazioni sindacali in Italia: Reports, various issues

The era of union centrality reached its political apex in 1975, with the signing of an agreement between the union confederations and Confindustria to upgrade the *Scala Mobile*, a system protecting workers’ wages against inflation. The agreement provided for a three month payment of a fixed amount for each unit increase in the inflation rate, known as the *punto di contingenza*.[xiv] The main features of the agreement, which was the product of collective bargaining and not the result of a parliamentary process[xv], were the relatively high and immediate degree of inflation protection paying equal amounts to all workers and thus reducing wage differentials, and the automatic character of the system. The agreement represented a major victory for the union movement. However, the defence of this victory proved to be very problematic and, with the beginning of the economic crisis of the late 1970s and early 1980s, eventually led to major conflicts not only between the unions and their social and political referents, but also within the unions themselves.

In the face of the growing economic problems, particularly unemployment, the Italian Union Federation[xvi] adopted a new strategic orientation in 1978, called the EUR strategy. This was based on a trade off between fewer guarantees to the workers and more participation in investment decisions, and it was aimed at increasing employment through the new instrument of tripartite negotiations with the government and employer representatives. Given the increasing involvement of the Italian Communist Party in the governmental area, thanks to the pacification process between the PCI and the DC (the so-called ‘historic compromise’), this ‘new course’ of Italian unions appeared to secure their participation in the official sites of decision making on Italian economic policies. On the contrary, in the light of the subsequent tragic end to 'national solidarity', the EUR strategy marked the beginning of a descending parabola of union bargaining power and political influence (Accornero 1994). The historic compromise suffered a serious blow with the 1978 kidnapping and subsequent murder of DC leader Aldo Moro.

The dismantling of the *Scala Mobile*, or at least the substantial reform of its mechanisms, together with the reduction of state intervention in the economy, constituted the main issues at stake in the domestic debate over the establishment of the European Monetary System. Indeed, it was precisely in the course of this debate that the differences within the governmental majority and within the union federations over the future of the *Scala Mobile* became unbridgeable. Within the union movement itself, the 'automatic' increases of the *Scala Mobile* were increasingly attacked. This is true especially for the UIL, which in this period was beginning to be controlled by the new Socialist Party (PSI) of Craxi (Merkel 1987), and for the CISL, traditionally linked to Catholic interests and to the DC. By 1982, for instance, both Pierre Carniti, Secretary General of the CISL and Giorgio Benvenuto, Secretary General of UIL, were favourable to a major reform of the wage indexation mechanism within the context of tripartite negotiations. On the other hand, the Communist component of the CGIL was far less ready than the others to modify the system. The inconsistencies in the positions of the different unions eventually led to the first major blow to the *Scala Mobile* represented by the accord of 22nd January 1983 (Lange 1986: 30). With this accord, for the first time since 1975, the unions accepted the reduction of the automatic inflation-indexed payments coupled with an eighteen month freeze of wage bargaining in the private corporate sector. This constituted a major defeat, the significance of which should not be underestimated, even if the government agreed to protect the real purchasing power of workers by cutting taxes, limiting the rise of government controlled prices and changing the family allowance system.

Given the compromise nature of the 1983 accord and the fact that the balance of power between unions and employers was still shifting towards the latter, in late 1983 the unions agreed to pursue a possible revision of the 1983 accord. The issues at stake were still wages and job flexibility and, above all the *Scala Mobile*, but this time Confindustria was taking a much tougher position and the unions reached the negotiating table without having achieved a joint position. The CISL and the UIL were favourable to further reductions in the *Scala Mobile,* while the CGIL made the reform of the system conditional on the government's commitment not to distribute the costs of further economic growth and employment exclusively among the working class. The situation was further complicated by the governmental leadership of Bettino Craxi, who sought to enhance the power of the executive in taking hard economic policy decisions (*decisionismo*) and by an even stronger opposition to the Communist Party. The atmosphere was so heated that in early February 1984, the communist and the socialist factions of the CGIL split, assuming different positions on the *Scala Mobile* and on the need to consult the workers before signing any agreement. This step slowed, if not prevented, CGIL participation in any compromise. On the 12th of February the Minister of Labour Gianni De Michelis presented a draft accord that maintained the trade off nature of the 1983 accord. It proposed a limitation of the number of units to be paid every three months during 1984, but it also promised that the following year fiscal interventions would compensate any unforeseen losses in case there came higher inflation rates. The CISL and the UIL promptly declared their willingness to conclude negotiations, while the CGIL, after a moment of hesitation, declared its unwillingness to accept it, thus joining the PCI in its negative assessment of the manoeuvre. Open conflict broke out between the government on one side, and the PCI and the communist component of the CGIL on the other side, when Craxi translated the basic terms of the 14th February protocol into a decree to be converted into law. Despite the campaign of the communists and their parliamentary allies, especially the deputies of the *Democrazia Proletaria*, and despite the massive popular demonstrations throughout Italy, this eventually happened on 12th June 1984. In June the PCI decided to pursue a referendum on article 3 of the decree, which was the one that concerned the cuts to the *Scala Mobile*. By late September more than the required number of signatures had been submitted. On the 7th of December 1984 the Central Office of the *Corte di Cassazione* declared the referendum constitutional. On the 9th and 10th of June 1985, after a long and bitter referendum campaign had further complicated by the administrative elections of 12th May 1985, Italian voters finally defeated the PCI's efforts to overturn article 3 when 54.3% voted 'no' and only 46.7% voted 'yes'.

The long battle over the *Scala Mobile* made it manifestly clear that the era of Italian political economy characterised by the market and political power of the union movement and by the PCI's ability to act as a political 'guarantor' of union cooperation with government policy had come to an end. The battle over the *Scala Mobile*, transcending its economic meaning, became a struggle over the balance of power within the different Italian socio-political and economic actors. The issue at stake was the control over the pattern of growth and distribution in the Italian political economy. With its conclusion, the basic contours of the political economy had fundamentally changed and the era of union centrality had ended with the labour movement and the PCI as net losers.

4.2. Italy, EMU and labour market flexibility

The tendency of the Confindustria to approach the problems of labour costs through the mechanisms by which they are determined, starting from indexation, was confirmed by the following round of the battle over the *Scala Mobile* which led to its definitive abolishment with the 1993 agreement.

After a long controversy between the CGIL, CISL, UIL, Confindustria and the government, the latter had, with the law No. 191 (13th July 1990) extended the *Scala Mobile* for the whole year 1991. However, from January 1992 the mechanism was again under the bargaining autonomy of the social partners. At the expiration of the deadline, the government confirmed, with the Protocol of December 1991, its firm decision not to allow any other extension by law of the *Scala Mobile* (Talani 2000). It indeed stated that all the problems relating to a new general system of bargaining and to the structure of retribution should be tackled by the 1st of June 1992. The battle was likely to be extremely tough unless some external factor arose pressing the trade unions, or better the CGIL, to accept the agreement on wage policy as the only possible alternative to the abyss. This external factor was represented by the speculative attacks on the lira within the Exchange rate mechanism of the European Monetary System.

This does not necessarily mean that the Italian economic elite provoked the speculative attacks, but the Italian employers' class certainly acted within the limits of the possible. Indeed, the Protocol eventually signed on 31st July 1992 represented a major victory for the employers. The trade unions had agreed to the almost complete elimination of the *Scala Mobile* and had accepted that wage bargaining at plant level for the whole 1993 would be blocked in exchange of a forfeit sum of Lit. 20.000 (+ $8) a month for all workers (Talani 2000).

The question of the structure of wage bargaining, not tackled in the Protocol, was left to further negotiations, leading to the agreement of 1993. The latter institutionalised the new balance of power between Italian social partners by introducing two levels of collective bargaining: the national and the plant levels. Moreover, it provided the launch pad for future changes of social protection legislation, particularly reform of the pension system (Regini et al 1997). Finally it increased the level of flexibility of the Italian labour markets by improving the Italian training system (boosting internal flexibility) and legalising temporary work agencies (improving external flexibility) (Rhodes 1997: 14).

In the context of the decreasing bargaining power of the trade unions, some steps towards the deregulation of employment conditions had already been taken with the Law 223/91which modified the procedures of placement by introducing the so-called 'nominative call' in place of the 'compulsory call'. It also recognised collective dismissals as a possible solution for firms' crises, a measure which, together with the introduction of a new instrument of mobility insurance (a longer form of early retirement), was supposed to guarantee Italian companies the freedom to fire staff in case of necessity (Gualmini 1998). Coming to the hire side of liberalising policies, Law 223 abolished the obligation for firms to choose workers from the compulsory hiring lists (*liste di disoccupazione*) and introduced the principle of free choice.

In terms of job creation and labour market flexibility, a number of further initiatives were taken later on, particularly by the Berlusconi governments, on the effectiveness of which, however, some doubts have been cast. Law 451/94 introduced the so-called 'public utility works'[xvii] which seemed to many yet another form of badly concealed *assistenzialismo* whose only outcome was to postpone the problem of unemployment for a very limited number of people. Moreover some fiscal incentives for young employers starting new enterprises were introduced by the first Berlusconi government, as was a law on ad-interim jobs.

However, it was the second Berlusconi government, elected in May 2001, that would be the most active on the side of labour market flexibility.

On the 3rd of October 2001, the then-minister of Labour, Roberto Maroni, presented a white book on the labour market (*Libro Bianco sul mercato del lavoro*) containing a number of measures to render the Italian labour market more flexible.[xviii] On the 15th of November 2001, the government proposed a draft law (the *Disegno di legge delega* Ddl 848) to delegate to the government the power to legislate on all issues relating to employment and labour market.

After a long period of social struggle amongst the Italian socio-economic groups, and after the murder of the father of the labour market reform, Professor Marco Biagi, the government and 39 employers' and employees' associations signed, on the 5th of July 2002, the so-called Pact for Italy (*Patto per l'Italia*), declaring the necessity to adopt the law as soon as possible[xix]. On the 5th of February 2003 the Italian Parliament finally approved the Ddl 848 which became the Law n.30 of the 14th of February 2003, also known as the Biagi law. The latter entered into force on the 13th of March 2003. From that day onwards, the government has had the power to pass any laws regarding the reform of the labour market without having to go through the parliamentary procedure.

The content of this reform is clearly oriented towards a marked increase of the degree of liberalisation and flexibility of the labour market. It is however important to note that the overall rate of unemployment is not the only problem to be faced by Italian labour. More serious challenges arise from the pervasiveness of the black market and the great differences in terms of region, age and gender.[xx]

5. Conclusions

In conclusion, the neo-functionalist case automatically linking the establishment of EMU to the flexibility of labour markets seems to conceal a number of power struggles amongst the different socio-economic groups at both the national and the transnational levels.

Indeed, the implementation of an EU employment strategy relying significantly on labour market flexibility, the rationale of which is often neo-functionally linked to the establishment of EMU, is certainly not the only possible approach to European unemployment and is the outcome of a series of political decisions taken by the Member States within the context of the EU institutions and procedures. Furthermore, the implementation of flexible labour market policies was itself made possible by the strengthening of the bargaining power of employers' organisations which was reflected in the institutionalisation at the European level of the neo-liberal economic paradigm focusing on the implementation of strict monetary and fiscal policies.

If it is true that the process of globalisation has modified the role of the nation state from the welfare model to the Anglo-Saxon model or 'competition state' (Cerny 1999), it might be argued that the process of regionalisation allows for a simplification of this process by strengthening the institutional power of transnational capitalist elites vis-à-vis organised labour in the shift from the national to the European level of governance. This game of transnationalisation is indeed much more easily played by employers' organisations than by the unions, given the many divides within the labour interest representation groups and the disaggregating tendencies embedded in the present globalised capitalist structure.

Whether, then, this process of transnationalisation is the outcome of the pro-active role of organised transnational actors or is the inevitable result of the restructuring of the world economy in the context of globalisation, is a subject for further analysis.

As far as this article is concerned, it seems clear that this redefinition of the power relations amongst socio-economic groups is well advanced and was clearly favoured by the role played by the process of European monetary integration.

Notes

[i] See Bank of Italy 2011
[ii] See Bank of Italy 2011
[iii] See Bank of Italy 2011:61
[iv] See FT, 24/02/12
[v] See FT, 24/02/12
[vi] See FT, 24/02/12
[vii] See FT, 24/02/12
[viii] See ECB statistics,available at http://www.ecb.int/stats/gov/html/dashboard.en.html as accessed on October 9, 2012
[ix] Ibid.
[x] Ibid.
[xi] Ibid.
[xii] See Manganelli, S. and Wolswijk,G. (2009),"What drives spreads in the euro area government bond market?",*Economic Policy*, 24: 191-240. Arghyrou, M.G. and Kontonikas, A., (2010) *The EMU sovereign-debt crisis: Fundamentals, expectations and contagion*,.Cardiff Economics Working Paper, N. E2010/9. See also Monfort, A., and Renne, J.-P., (2011) *Credit and liquidity risks in eurozone sovereign yield curves*. Paris: Banque de France Working Papers Series, n. 352. Haugh, D., Ollivaud, P., D. Turner, (2009) *What drives sovereign risk premiums? An analysis of recent evidence from the eurozone*..Paris: OECD Economics Department Working Papers, N. 718. Gerlach, S., Schulz, A. and G.B. Wol (2010). *Banking and sovereign risk in the euro area*..CEPR Discussion Paper, n. 7833.Attinasi, M.G., Checherita, C., and C. Nickel, (2009). *What explains the surge in euro area sovereign spreads during the financial crisis of 2007-09?*. ECB Working Paper Series, n. 1131. Barrios, S., Iversen, P., Lewandowska, M. and R. Setzer, (2009) *Determinants of intra-eurozone government bond spreads during the financial crisis.*Brussels: European Commission, Directorate General for Economic and Financial Affairs, Economic Papers, N. 388.

[xiii] The seminal work on OCA Theory is: Mundell, R., A., (1961), "A Theory of Optimum Currency Areas" *The American Economic Review*, 51:4, 657-67; for an application of the theory to the Euro area see Boyoumi, T., and Eichengreen, B., (1996), "Ever closer to heaven? An Optimum Currency Area Index for European Countries", *Centre for International and Developing Economics Research Working Paper Series No. C96-078* California: University of California Berkeley; McKinnon, R., (2000), "Mundell, the Euro, and Optimum Currency Areas", *Stanford University Working Papers in Economics, No. 009*, Stanforud University

[xiv] It is important to note that in the same year, 1975, the Bank of Italy committed itself to buy all unsold Treasury Bills.

[xv] Art. 39 of the Italian Constitution indicates the requisites for a collective agreement to achieve the force of law, but this article has never been implemented.

[xvi] The Italian UIL (a federation of CGIL and CISL) was established in 1972 and lasted until 1984 when, during the heated debate over the *Scala Mobile*, it was dismantled.

[xvii] The law allowed public administrations and some private organizations to promote projects for works of public interest and to use long-term unemployed selected from the *liste di disoccupazione* for a limited period of time.

[xviii] For more information see the web-site of the Italian Labour Ministry at www.welfare.gov.it

[xix] For all the information relating to the pact and for the text see http://www.welfare.gov.it/NR/rdonlyres/ebuv5tvajrasify2koysjz3z7zola7h2zfbzogaiekkuoevsx2zavq22sftghelciyudq3m4vljpyh/20020905pattoitalia.pdf

[xx] For the related data see the Italian Statistical Institute (ISTAT) web site at the following address http://www.istat.it/

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