**Relations with Europe: Beyond the *Vincolo Esterno***

Erik Jones[[1]](#footnote-1)

In his closing argument for the referendum campaign, Italian Prime Minister Matteo Renzi made the claim that a ‘yes’ vote would ensure that Italy had a strong voice in Europe.[[2]](#endnote-1) Italian perspectives on issues related to macroeconomics, financial stability, and immigration must be represented, he argued. Moreover, only a strong voice like his has a chance to sway other European leaders. Should Renzi leave office after a failed referendum vote, so the argument concluded, not only Italy but also Europe would suffer.

As we know, the people voted overwhelmingly against Renzi’s constitutional reform package in the 4 December referendum.[[3]](#endnote-2) Renzi resigned from office soon thereafter and his foreign minister, Paolo Gentiloni, formed the new government. Whether Renzi was right in his assertion about the critical nature of his personal involvement for Italy’s role in Europe is still to be determined. Renzi’s closing argument merits close attention nonetheless.

The focus here is on what Renzi’s argument implies about Italy’s relationship with Europe. There was a period stretching from the late 1980s through the recent financial crisis when Italy played a low-profile role in European affairs; during that period, ‘Europe’ played an oversized role as an external constraint – or *vincolo esterno* – in Italian politics. In Renzi’s analysis, that situation is now reversed. Italy has an important role to play in Europe; Italian domestic politics is the source of constraint.[[4]](#endnote-3)

There is some merit to Renzi’s assertion. The events that unfolded in 2016 reveal the extent to which Europe no longer plays a useful role as an external constraint in Italian politics. In many respects, the role of Europe is counter-productive. By contrast, Italy has an important role to play in European debates. Renzi may not be the only possible Italian politician to represent the country’s interests effectively, but the European project will benefit more from Italian leadership than from its absence or acquiescence.

This argument is made in five sections. The first sets out the traditional argument for Europe as a necessary *vincolo esterno* in Italian politics. The next three focus on issues related to macroeconomics, financial stability, and migration. The fifth section concludes with suggestions about the role of Europe in Italy and Italy in Europe.

**The Advantages of Tying One’s Hands**

The idea that Europe could serve as a constructive constraint in Italian politics dates to a time when the macroeconomic policies of the country needed an external anchor. Active participation in the exchange rate mechanism of the European Monetary System played that role. By binding the Lira ever more tightly to the currencies of other countries in the late 1980s, the Italian government made a visible (and hence also credible) commitment to reining in domestic inflation, tightening government deficits, and ultimately paying down the public debt.[[5]](#endnote-4)

What works for macroeconomic policy can also work in other areas. Hence as European integration deepened in the 1990s to touch on a wider spectrum of policies related to the functioning of the internal market, the Italian state necessarily adapted to the new constraints this implied. This adaptation had virtue beyond the transparency and credibility of a monetary anchor; ‘Europe’ became a means of insulating Italian policymakers from the demands of special interest groups as well.[[6]](#endnote-5)

The efforts made by Prime Minister Romano Prodi and his government to bring Italy into the euro as a shared multinational currency represented an early culmination of the political strategy of using Europe as an external constraint. Prodi not only managed to convince the markets that Italy would join the euro (and so brought down borrowing costs), but he also managed to persuade powerful interest groups like the trade unions that they should cooperate with the government in undertaking reforms toward the achievement of that objective.[[7]](#endnote-6)

The *vincolo esterno* evolved from a symbol of commitment and a source of domestic insulation to become something more like a personal trainer – helping Italy to achieve its potential in a disciplined and yet still supportive regional environment. The results were not perfect and there were many critics who believed that successive governments could and should have done more to improve economic performance. Such criticisms extended to Italy’s participation in the euro as well.[[8]](#endnote-7) Nevertheless, there few if any who made for Italy either to leave Europe or to lead it.

This continuity should not be exaggerated. There was a period around the start of the global economic and financial crisis when Italy and Europe appeared to move apart. After his victory over Roman Prodi in 2008, Silvio Berlusconi began suggesting that Europe had little to offer as a meaningful constraint and Italy had little to gain from European tutelage. While the North Europeans bailed out their banks and the Greeks worried about their sovereign debt markets, Berlusconi’s government made a point of highlighting how little their country was affected by the growing turbulence and focused their attention of domestic matters instead.[[9]](#endnote-8) This argument was not completely credible – Italy was more powerfully affected by the crisis than Berlusconi was willing to admit – and yet it managed to shift the conversation away from any discussion of Europe as Italy’s *vincolo esterno*.[[10]](#endnote-9)

That situation changed dramatically in the summer of 2011 after financial market participants began to lose faith in Berlusconi’s government. Within a matter of weeks, international investors sold hundreds of billions of euros worth of Italian sovereign debt, plunging the country into crisis. Once again Europe emerged as a necessary bulwark; it also operated as a powerful constraint. European Central Bank (ECB) President Jean-Claude Trichet wrote directly to Berlusconi and his ministers to set out the reforms they would have to introduce in exchange for more stable sovereign debt markets. When Berlusconi proved unable to comply with this request, the President of the Republic, Giorgio Napolitano, looked for someone who would be considered more credible in the eyes of the rest of Europe. The situation culminated at the November 2011 G-20 summit in Cannes. U.S. President Barack Obama intervened personally with Europe’s leaders to request decisive action to stabilize both Italy and Greece.[[11]](#endnote-10) Soon thereafter, Berlusconi resigned from office and Napolitano appointed two-time European Commissioner Mario Monti in to take his place.[[12]](#endnote-11)

Both the Monti government and the government headed by Enrico Letta that succeeded it worked hard to earn that credibility in the eyes of the rest of Europe. They committed to undertake domestic reforms and they participated actively in the transformation of Europe’s wider policy framework. Along the way, they benefited greatly from the support that European institutions could offer – starting with the ECB but extending to the European Commission and the Council of Ministers. Both Monti and Letta put forward new European initiatives as well. These were not always successful, but it is important to stress that neither they nor Italy was simply a passive participant in the European project. The point is simply that Europe regained its status as *vincolo esterno* – helping Italian policymakers by creating a supportive and yet disciplined policy environment.

**Imbalanced Macroeconomics**

The problem from the perspective of the Renzi government was that the discipline Europe requires is not always supportive of Italy’s interests or objectives. This is particularly true on the macroeconomic front. The European Union elaborated a raft of new policy procedures during the heat of the economic and financial crisis designed to prevent moral hazard on the part of highly indebted governments and to promote flexibility and competitiveness as the main instruments for macroeconomic adjustment.[[13]](#endnote-12) These reforms sound reasonable at first blush. Who would embrace moral hazard or reject competitiveness? Beneath the surface, however, the procedures favor some countries over others. Specifically, any country that can operate as a safe-haven for financial market participants – and so attract liquidity during times of crisis – benefits from lower interest rates and easier lending conditions, while countries that risk losing foreign investment or suffering from domestic capital flight face tighter monetary conditions.

The argument with respect to flexibility and competitiveness is more complicated because it is counterintuitive. Everything else being equal, a safe-haven country will always look more competitive and flexible than a country that experiences capital flight. To understand why, it is necessary to focus on the cost of capital that results from cross-border movements. A country that receives flight capital from other countries can always ensure low borrowing costs, even if it sends its own domestic capital abroad – which is what happens when a country exports more than it imports. The firms of that country can also afford to pay marginally higher wages in comparative terms because their cost of capital is going to be lower. Hence, we should expect a safe-haven country to be able to maintain a current account surplus even if it experiences rising wages as a result of a fall in unemployment. By contrast, countries that experience capital flight see their borrowing costs rise as capital departs and firms operating in those countries must push down relative wages to compensate for the higher cost of capital. These countries will find it difficult to finance a current account deficit; whether they can run a surplus will depend a lot on how much of their exports they can sell into foreign markets and how much of their typical import consumption they can either produce domestically or do without. In the meantime, these flight countries will experience rising unemployment that must be more than compensated by falling wages since the cost of capital for firms is increasing as well. Macroeconomic growth in the flight countries will be slow to negative as a consequence.

The European macroeconomic framework that evolved through the crisis increased the division between safe-haven countries and flight countries rather than mitigating it. This can be seen in three different mechanisms that were introduced in 2011 and 2012: the use of structural budget indicators in assessing fiscal performance (Regulation 1175/2011);[[14]](#endnote-13) the emphasis on fiscal consolidation and debt sustainability at a time when cross-border capital flows render monetary policy less effective (Fiscal Compact);[[15]](#endnote-14) and, the asymmetrical treatment of current account performance (Regulation 1174/2011).[[16]](#endnote-15) Structural budget indicators tend to punish governments with economies that underperform systematically; emphasis on fiscal consolidation puts downward pressure on growth that can make it even harder to achieve targets expressed in terms of deficit- or debt-to-output ratios; and the failure to criticize countries that run persistent current account surpluses can lead to inadequate demand in safe-haven countries even as demand is collapsing in those countries that experience capital flight.

The Renzi government sought to rectify this imbalance in the European macroeconomic framework through the publication of ‘A Shared European Policy Strategy for Growth, Jobs, and Stability’ on 22 February.[[17]](#endnote-16) That document makes it clear that fiscal targets should consider ‘the impact of very low nominal growth on potential growth and on debt dynamics’; that ‘fiscal space should be fully used to support growth’; and that ‘more symmetry is needed in macroeconomic adjustment’ insofar as ‘very large current account surpluses have a negative impact on the overall functioning of the Eurozone just as current account deficits.’[[18]](#endnote-17) The strategy note was timed to circulate just prior to the spring meetings of European heads of state and government as part of the overarching macroeconomic policy coordination framework. The Renzi government did not expect to set the agenda for these meetings but it did plan to lay out an important marker.[[19]](#endnote-18)

The northern European countries – meaning not just Germany, but also countries like Finland, the Netherlands, and even Austria – were unsupportive of Renzi’s initiative. Instead, they sought to hold the line on strict macroeconomic policy coordination and fiscal consolidation. Within the European Commission, however, there was appreciation for the fact that Renzi was willing to start a conversation. The Commission did not necessarily agree with all aspects of Renzi’s proposal, but they respected his ability to speak up and be heard.[[20]](#endnote-19)

The difficulty for Renzi and his government lay in the fact that Italy struggled to meet its own fiscal targets. This was understandable given the country’s persistently slow growth and high unemployment. The real economy in Italy grew just 1.0 percent between the third quarter of 2015 and the third quarter of 2016;[[21]](#endnote-20) meanwhile, unemployment remained stuck at around 11.6 percent.[[22]](#endnote-21) Nevertheless, the need for the Renzi government to request flexibility from the European Commission in its role as fiscal watchdog gave the ‘shared European policy strategy’ a veneer of self-interest that was hard for the Renzi government to shake. Each time the Commission granted flexibility to Italy, the imperative to address the more general argument about the need for a more balanced approach to macroeconomic policy coordination diminished. And each time Renzi attacked European institutions for their inflexibility, the perception that his government was both unsympathetic and ungrateful increased. This dynamic started even before the year began, it continued through the publication of the Italian strategy paper, it was on full display when the heads of Europe’s institutions came to Rome in May, and it continued through the following summer.[[23]](#endnote-22)

The tragic earthquakes that struck Italy in August and October made matters worse. The Renzi government insisted that they should be given additional flexibility in meeting their targets for deficit reduction considering the expenses required to respond to this natural disaster. Such flexibility should encompass the disproportionate costs that Italy must shoulder in response to the flow of migrants across the Mediterranean as well (about which, more below). The Juncker Commission was sensitive to these arguments and yet reluctant to relax the fiscal pressure on the Renzi government. This reluctance was due in no small measure to the political constraints placed by the Northern European member states on the Commission itself. Nevertheless, it was perceived by the Renzi team as another example of excessive rigidity and asymmetry in the pattern of European macroeconomic policy coordination.

The conflict came to a head in late October and early November as the European Commission made its assessment of Italy’s budget proposal for 2017.[[24]](#endnote-23) The result was a partial concession on the part of the Commission, which noted that Italy ran ‘the risk of non-compliance with the provisions of the SGP [Stability and Growth Pact]’ and yet conceded that ‘Italy has made some progress’ in meeting the requirements for ‘the structural part’ of the fiscal consolidation process.[[25]](#endnote-24) The result left both parties dissatisfied: The Commission faced renewed criticism from the countries of Northern Europe, particularly Germany, while the Renzi government found itself will insufficient fiscal room for maneuver.[[26]](#endnote-25) As Renzi prepared to leave office, the European institutions called for the Italian government to prepare for additional consolidation measures.[[27]](#endnote-26)

**Accumulated Financial Instability**

Macroeconomic policy coordination was not the only source of constraint on the Renzi government. Financial supervision was arguably even more important. The source of the constraint was the European Union’s new ‘banking recovery and resolution directive’ (BRRD).[[28]](#endnote-27) This is European legislation published in May 2014 to come into effect on 1 January 2016. The goal of the legislation is to ensure that taxpayers do not carry the full responsibility for banking failures and that investors – particularly sophisticated investors who earned higher returns for accepting riskier assets or for making larger deposits – share some of the burden when banks must be restructured or resolved. Moreover, while the full force of the legislation only started on 1 January, the directive suggested that this burden-sharing should be applied even before the start date ‘in order to allow for effective resolution outcomes’.[[29]](#endnote-28)

In November 2015, Renzi used a rough approximation of the burden-sharing formula from the BRRD to restructure four small regional banks: Banca Etruria, Banca Marche, CariFerrara, and CariChieti. He did not do so out of excessive enthusiasm for the new regime but to avoid complaints by the European Commissioners for Competition Policy and Financial Services about violating European requirements.[[30]](#endnote-29) In doing so, he wiped out the savings of a number of small retail investors who had purchased bank bonds in the highest risk category – called ‘subordinated’ debt because it is the last to be repaid if there is a problem. Many of these small retail investors were private individuals who lacked the financial sophistication to understand the risks they had assumed in purchasing the debt in the first place. They also lacked any knowledge that the introduction of the BRRD had greatly increased the likelihood that their savings would be taken if the bank whose bond they purchased were to get into trouble.[[31]](#endnote-30) It also emerged that one of Renzi’s key ministers, Maria-Elena Boschi, was implicated indirectly in one of the failing institutions insofar as her father was a director of Banca Etruria. Although there was no immediate evidence that this resulted in wrong-doing, the connect raised questions about whether there was a conflict of interest.[[32]](#endnote-31)

Renzi and his government quickly moved to neutralize the scandal and to find some way to compensate those individuals who should never have been exposed to subordinated debt instruments in the first place. Neither of these efforts was immediately successful. The scandal dragged on both because of the intensity of the losses for the individuals concerned and as Boschi’s father was investigated for alleged fraud. Meanwhile, the compensation measures took much longer to organize and implement than to promise; by the end of 2016, many who lost money in the four small banks were still waiting for recompense.[[33]](#endnote-32) Worse, the underlying problem that resulted in the restructuring of the four banks was widely spread. A number of other, larger banks also had large volumes of ‘non-performing loans’ on their balance sheets.

This notion of ‘non-performing loans’ warrants explanation because the Italian situation is unique in many respects. By European standards, Italian banks are very conservative. They do not rely on sophisticated financial products like derivatives to make their profits; they also do not borrow heavily in relation to their assets (called ‘leverage’). Instead, Italian banks tend to engage in very straightforward lending – mostly to small and medium-sized enterprises but also to larger non-financial corporations. They also tend to be small and they tend to be focused on particular regions. There are a few large institutions like Intesa San Paolo or Unicredit, but they are the exception. As a result, many Italian banks tend to operate as mutuals or cooperatives, meaning the clients are the share-holders; even the larger banks that are publicly listed tend to have started as regional cooperatives before going through the process of ‘demutualization’.

This background explains why Italy appeared to do so well during the initial phases of the global financial crisis. While the rest of Europe experienced bank failures – often involving very large institutions – in the period from 2008-2010, the smaller Italian financial institutions were not heavily exposed to global financial markets or to ‘toxic assets’ and so remained unaffected. As the financial crisis moved into the real economy of manufacturing and employment, however, the situation became very different. The European banks that were restructured during the early phases of the financial crisis were better positioned to weather the prolonged economic downturn. By contrast, Italian banks watched as their traditional customers began to draw down their savings and to fall behind on their loan payments. The situation worsened considerably when foreign investors began to abandon Italian sovereign debt markets. This capital flight pulled liquidity out of Italian financial markets and so forced banks to tighten up on their lending to small and medium-sized companies. The banks would still lend to their larger, more international clients, but any firm that depended on the Italian market for its profitability was left behind. In turn, this tightening of credit conditions slowed down the economy further, causing more depositors to draw down their savings and more borrowers to fall behind on their payments. The volume of loans in the Italian banking system that classified as ‘non-performing’ because the borrowers were more than three months behind in payment or were bankrupt was €78 billion in 2010, €156 in 2013, and €201 billion by the start of 2016.[[34]](#endnote-33)

The challenge for the Renzi government was two-fold: it had to restructure the Italian financial sector in order to deal with the huge volume of non-performing loans and it had to find some way to encourage the banks to lend more to the non-financial sectors of the Italian economy. These two challenges are linked through a vicious circle. The more banks have to set aside resources to cover the losses on bad loans they made in the past, they less money they have to lend in the present, which means that present economic activity will be slower than it should be, and it means that more existing loans are likely to go bad in the future.

The Renzi government’s generic response was to work on consolidating the banking sector in order to demutualize remaining cooperatives so that it could then encourage the banks to combine into larger, more diversified, and more efficient institutions.[[35]](#endnote-34) The merger of the Banca Popolare di Milano with Banco Popolare to create Gruppo BPM is a good illustration. Separately, the two banks were owned by their customers and devoted to their regions; together they form Italy’s third largest financial institution in terms of assets and the group is publicly traded on the Milan stock exchange. That said, the process of combining the two banks was not easy. The existing share-holders of both institutions had to accept the terms of the merger, they had to agree to the loss of control implied by a new corporate governance structure, and they had to accept the prospect that the new, larger institution would be less conservative in terms of financial strategy than either of its predecessors. This process started in March 2016 and culminated only by the end of the year. Even toward the very end, there were doubts as to whether and how well the merger would work.[[36]](#endnote-35)

At the same time that it tried to rationalize the banks, the Renzi government also had to strengthen the mechanisms for resolving non-performing loans. The key element in this process is to make it easier for the banks to seize the collateral that has been pledged by borrowers. On 3 May the government promulgated a decree that would speed up the process through which banks could foreclose on loans in the event of non-payment. These provisions make it possible for the banks to seize and dispose of assets pledged as collateral without having to go through lengthy court proceedings. As a result, they make it more likely that the banks will recover a larger percentage of the principal (or book value) of the original loan. The result is not perfect insofar as the decree applies only to new lending. Nevertheless, the Renzi team argued that it is enough to given lenders greater leverage over borrowers who fail to make repayments. The parliament converted the degree into law on 30 June.[[37]](#endnote-36)

The events that unfolded alongside these government initiatives underscored the urgency for action. They also highlighted the problems that the Renzi government had complying with the constraints created by European competition law and by the BRRD. Two narratives deserve particular attention: one focuses on the creation of the Atlante fund for bank recapitalization and to support the securitization and resale of non-performing loans; the other concerns the plight of Monte dei Paschi di Siena.

The Atlante fund is the easier of the two stories. Initially the fund was created to support the recapitalization of two banks – Banca Popolare di Vicenza and Veneto Banca. The government called for private banks to contribute to the fund which would be managed by a private entity. This complicated arrangement was necessary to avoid the charge that any funds deployed to support the two banks would constitute unlawful ‘state aid’ in the eyes of the European Commission. The two largest contributors were Unicredit and Intesa San Paolo. The reason was simple. Unicredit has already pledged to underwrite the new capital for Banca Popolare di Vicenza. If that rights issue failed, Unicredit would have to buy the bank itself. This would require Unicredit to absorb the bad assets of Banca Popolare di Vicenza on its own balance sheet. By giving the same amount of money to the Atlante fund, Unicredit could ensure that the capital rise would be a success without having to absorb the bad assets on its own balance sheet.[[38]](#endnote-37) Intesa San Paolo faced a similar exposure to Veneto Banca. In the end, the effort to raise fresh capital for both smaller banks failed and so Atlante ended up being the major share-holder for both of them. This left the fund with few resources to invest in creating a market for the non-performing loans of other struggling financial institutions.[[39]](#endnote-38)

The story of Monte dei Paschi di Siena (MPS) is more complicated. Prior to the creation of Gruppo BPM, MPS was Italy’s third largest financial institution. It is also the world’s oldest bank. And, in many ways, MPS reveals the whole range of flaws characteristic of the Italian financial system. It has governance institutions that allowed for excessive political influence over business strategy; lending practices that concentrate excessively on the Tuscan region; large exposure to non-performing loans; and a history of selling subordinated debt as investments to small retail investors who probably could not anticipate the risks they faced if the bank ran into difficulty. Because of its size, MPS could not be allowed to fail without threatening the stability of the whole Italian finance system. Because of its close proximity to the Democratic Party, MPS could not be given special treatment without reinforcing the perception of ‘conflict of interest’ that tainted the resolution of the four smaller institutions in November 2015. And because of its importance to Tuscany and the exposure of more than 40,000 households to its subordinated debt, MPS could not be forced into the kind of burden-sharing arrangement required by the BRRD without triggering a popular revolt against the Renzi government.[[40]](#endnote-39) Nevertheless, because of its exposure to non-performing loans, MPS could not be ignored if it were to remain solvent. The Renzi government had to confront the problems of the bank eventually.

The problem for the Renzi government was to find a way to reorganize MPS without falling afoul of European regulations for market competition, state aid, and burden-sharing. The European Commission was willing to make some concessions. Both in January and in June, the Commission authorized the Italian government to issue state guarantees for bank debt so that institutions like MPS could gain easier access to funding.[[41]](#endnote-40) Such guarantees would also make it easier for the banks to sell their non-performing loans into the market. Unfortunately for the Italian government, however, the Commission insisted that any state guarantees would operate according to market principles so as not to distort competition. This limited the effectiveness of such guarantees in lowering the cost of funds for the banks. To make matters worse, in July the European Central Bank instructed MPS to sell off a large stockpile of its non-performing assets by the end of the calendar year.[[42]](#endnote-41) By implication, the requirement to confront the problems of MPS shifted from ‘eventually’ to ‘immediately’ just as the Renzi government was gearing up for its referendum campaign.

The solution worked out between the Renzi government and MPS unfolded in stages across the summer and autumn months and relied in the first instance on a ‘market-based’ reorganization of the bank’s balance sheet with a ‘state-based’ contingency in the event that MPS failed to win support from the market. Almost from the outset, however, the plan lacked credibility. It involved participation of a re-energized version of the Atlante fund to support both a capital rise and the disposition of non-performing assets; it included an international consortium led by JP Morgan to issue new shares for MPS without guaranteeing their eventual placement; and it implied a level of international confidence in the Italian banking system that simply did not exist.[[43]](#endnote-42) Nevertheless, the plan succeeded in prolonging the debate about how to resolve MPS until after the 4 December referendum. By implication, the Gentiloni government was responsible for restructuring the bank through a decree law issued on 23 December.[[44]](#endnote-43)

In the meantime, however, the situation worsened as MPS lost deposits while at the same time accumulating non-performing assets. The Renzi government argued repeatedly and consistently that decisive and early state intervention would have offered a superior alternative. In making that claim, Renzi pointed to the example of how the Northern European countries dealt with their own banks in the period from 2008 to 2010. His argument was simple: Europe is not offering constructive discipline for the Italian financial system; it is providing an arbitrary and unhelpful source of constraint on effective state action.

**Solidarity and Migration**

Renzi’s critique of European involvement extended beyond macro-economics and finance to touch on migration as well. That was apparent in his government’s 22 February ‘Shared European Strategy’ and it remained a recurrent theme throughout the year. There is little that is surprising in that emphasis. Migration has been a central theme in Italian politics for more than a decade and it has assumed increasing importance following the overthrow of the Gaddafi regime in Libya in 2011.[[45]](#endnote-44) The reason is simple: roughly 90 percent of all migrants who cross the Central Mediterranean route to enter Italy depart from Libya; when Muamar Gaddafi was in power, that route was closed; when Gaddafi was removed from power and Libya was thrown into political turmoil, the Central Mediterranean route opened.[[46]](#endnote-45)

European responses to the opening of the Central Mediterranean route have been to view this as an Italian problem. When the route opened initially in 2011, the French government immediately raised concerns that many of the migrants into Italy would move to other countries. A conflict broke out between then Prime Minister Silvio Berlusconi and French President Nicolas Sarkozy that resulted in a temporary reintroduction of border controls between France and Italy.[[47]](#endnote-46) Tensions cooled rapidly and yet the perception that migration across the Central Mediterranean is an Italian national problem rather than a collective European problem remained. The flow of migrants from Libya to Italy continued as well. The governments headed by both Mario Monti and Enrico Letta pushed hard for additional European support and yet failed to elevate the problem comprehensively to the European level.

The problem was not limited to migration. Large numbers of people perished attempting to cross the Mediterranean as well. Hence the Letta government introduced a naval operation to rescue migrants in the Strait of Sicily to mitigate the humanitarian disaster. This operation, called Mare Nostrum, did attract European attention. A number of Northern European countries worried that effective rescue operations would attract additional migration flows by lowering the risks associated with the Mediterranean crossing. Hence the EU lobbied to replace Mare Nostrum with a joint operation called Triton that would be less aggressive in engaging in open water interdiction. The hope was that by enhancing the risks, they would decrease the flow of migrants. Triton also offered to provide EU resources to lighten the financial burden on the Italian government. When Triton started in October 2014, neither the flow of migrants nor the number of deaths at sea abated.[[48]](#endnote-47) And while EU resources provided a welcome addition, the new Renzi government nevertheless resumed the practice of open-water interdiction for humanitarian reasons.

The European perspective on migration changed fundamentally in August 2015 wither German chancellor Angela Merkel’s decision to suspend the Dublin protocols that require asylum seekers to seek refuge in the first ‘safe’ country of entry. The result was a massive surge of migration along the Eastern Mediterranean route that runs through Greece and the Western Balkans. That route had always carried more traffic than the Central Mediterranean route because the sea distances are shorter and so the transit is less perilous. It also carries a very different demographic group of migrants: people who cross the Central Mediterranean tend to come from Sub-Saharan Africa; those who cross the Eastern Mediterranean tend to come from conflict regions in the Middle East and Central Asia. Following Merkel’s announcement, migration along the Eastern Mediterranean route quickly eclipsed the Italian situation to become an existential crisis for the European Union. Resolving that crisis was ‘the’ challenge facing Europe’s heads of state and government. From the perspective of the Renzi government, however, concern about equal treatment for Italy was all but forgotten.

This contrast between the attention given by EU leaders to the Eastern Mediterranean route and the attention given to Italy came into sharp relief when Merkel negotiated an agreement with the government of Turkey in March 2016 to stop the flow of migrants into Greece. The widespread perception was that Europe’s migration crisis could be ‘resolved’ so long as this agreement remained in place. For Italy, however, that conclusion was not self-evident. The pace of migration from Sub-Saharan Africa into Italy increased in 2016 relative to the year prior and even outpaced the records set in 2014. At the same time, the number of deaths at sea also rose to record level.[[49]](#endnote-48)

The situation was even more complicated for the Renzi government because of the relative closure of Italy’s northern borders. Sarkozy’s 2011 complaint about migrants not staying in Italy had a large element of truth. Although many migrants arrive in Italy, most have tended to move on to other European countries. That movement became more difficult in the aftermath of the 2015-2016 crisis along the Eastern Mediterranean route. Even governments that had not reacted to migration out of Italy before – like Austria or Slovenia – became more sensitive to such movements now that the issue of migration had such high political salience. France and Switzerland also tightened controls. Consequently, increasing numbers of migrants who made their way into Italy found they could not leave. Italian reception centers filled up; efforts to redistribute migrants across the country ignited political controversy; and the Renzi government struggled to get more attention from the rest of Europe for the risks this situation posed to the country’s domestic political stability. Europe’s leaders agreed in principle to accept a share of the migrants who originally arrived in Italy but in practice very few migrants were ever relocated.[[50]](#endnote-49)

Tension between the Renzi government and the rest of Europe peaked at the informal European Council summit organized in Bratislava in September. The purpose of the summit was to coordinate a symbolic response to the British referendum decision to leave the European Union. Rather than coming together around a common vision, however, different European leaders attempted to rally support for their won projects. Renzi sought greater solidarity in the face of migration and was disappointed. In break with protocol, he declined to participate in the press conference that followed the summit and openly criticized his European partners for their failures. Unless and until the European Union forges a meaningful response to the problem of migration, he argued, European leaders will doom the project in the eyes of the public.[[51]](#endnote-50)

**A Different Relationship**

The relationship between Italy and the rest of Europe has changed fundamentally. The European Union is no longer a supportive, disciplinary environment for Italian governments. It does not help Italian ministers take unpopular decisions and it does not insulate Italian politicians from the pressures of domestic politics. The EU still operates as a sort of *vincolo esterno* for Italy but without many of the positive connotations that term held in the past. Instead, there are many issues – like macroeconomic policy making, financial stability, and migration – where European policies may not serve Italy’s national interest. This is not an argument against Italy’s membership in the European Union. On the contrary, there are many areas where Italy benefits. More important, those benefits are recognized by the governing Democratic Party, which is arguably Italy’s only comprehensively pro-European political movement.

The challenge for Italy is to present a coherent vision for the future of Europe. That is the challenge that Renzi undertook in 2016. He did not always succeed in this endeavor, but his efforts did not go unnoticed. On the contrary, U.S. President Barack Obama invited Renzi to be the guest of honor at the last state dinner to be hosted during Obama’s second administration. During the press conference that preceded the dinner, Obama made it clear that this invitation was in recognition of Italy’s contribution to the European project and to the transatlantic relationship. Italy still needs Europe, but Europe also needs Italy. Speaking at the same press conference, Renzi made a similar point about relations between Italy and the European Union:

we do respect the European rules and we’re totally inside the European rules, although sometimes we do this halfheartedly. We’d like to do things differently. But so long as rules don’t change, we will respect them, because Italy has made of its reputation one of the key words in its mandate. We work to change them, but if they’re there, we are going to respect them.[[52]](#endnote-51)

Perhaps this is a sign that Italy has become a more ‘normal’ European country.

Notes

1. Erik Jones is Professor of European Studies and International Political Economy at the Johns Hopkins School of Advanced International Studies and senior research fellow at Nuffield College, Oxford. Isak Jones provided research support for the preparation of this essay. The usual disclaimer applies. [↑](#footnote-ref-1)
2. See, for example, ‘Referendum, Renzi: “Se vince Sì diamo carte in Europa. Ridurremo ancora tasse”.’ *Il Sole 24 Ore* (25 November 2016); Jacopo Iocoboni, ‘Renzi: “Bisogna che vinca il Sì, in questo modo saremo più forti in Europa”.’ *La Stampa* (26 November 2016). [↑](#endnote-ref-1)
3. The results can be found here: http://elezioni.interno.it/referendum/votanti/20161204/FI01votanti.htm. [↑](#endnote-ref-2)
4. My interpretation of Renzi’s position on the role of Europe in Italy is not original. See, for example, Marco Valerio Lo Prete, ‘Guido Carli e quel "vincolo esterno" europeo che Renzi vuole rottamare (a parole),’ *Il Foglio* (25 January 2016). See also, James Politi, ‘Eurozone Austerity Fanning Populist Flames, Says Renzi,’ *Financial Times* (21 December 2015). [↑](#endnote-ref-3)
5. The classic reference here is Francesco Giavazzi and Marco Pagano, ‘The Advantages of Tying Ones’ Hands: EMS Discipline and Central Bank Credibility,’ *European Economic Review* 32 (1988) pp. 303-323. [↑](#endnote-ref-4)
6. See Vincent Della Sala, ‘Hollowing Out and Hardening the State: European Integration and the Italian Economy,’ *West European Politics* 20:1 (1998) pp. 14-33. [↑](#endnote-ref-5)
7. Maurizio Ferrera and Elisabetta Gualmini, ‘Reforms Guided by Consensus: The Italian Welfare State in Transition,’ *West European Politics* 23:2 (2000) pp. 187-208. [↑](#endnote-ref-6)
8. Marcello De Cecco, ‘Italy’s Dysfunctional Political Economy,’ *West European Politics* 30:4 (2007) pp. 763-783. [↑](#endnote-ref-7)
9. Riccardo Rovelli, ‘Economic Policy in a Global Crisis: Did Italy Get it Right?’ *Italian Politics* 25 (2010) pp. 223-241. [↑](#endnote-ref-8)
10. Erik Jones, ‘Italy and the Euro in the Global Economic Crisis,’ *The International Spectator* 44:4 (2009) pp. 93-103. [↑](#endnote-ref-9)
11. Timothy Geithner, *Stress Test: Reflections on Financial Crises* (New York: Crown Publishers, 2014) loc. 7316-7324. [↑](#endnote-ref-10)
12. Erik Jones, ‘Italy’s Sovereign Debt Crisis,’ *Survival* 54:1 (2012) pp. 83-102. [↑](#endnote-ref-11)
13. Erik Jones and Gregory W. Fuller, ‘European Macroeconomic Governance,’ in Jeremy Richardson, ed., *European Union Power and Policymaking, Fourth Edition* (London: Routledge, 2015) pp. 327-349. [↑](#endnote-ref-12)
14. http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32011R1175&from=EN. [↑](#endnote-ref-13)
15. http://www.consilium.europa.eu/european-council/pdf/Treaty-on-Stability-Coordination-and-Governance-TSCG/. [↑](#endnote-ref-14)
16. http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:306:0008:0011:EN:PDF. [↑](#endnote-ref-15)
17. ‘A Shared European Policy Strategy for Growth, Jobs, and Stability,’ (Rome: Ministero dell’Economia e delle Finanze, 22 February 2016) http://www.governo.it/sites/governo.it/files/ASharedPolicyStrategy\_20160222.pdf. [↑](#endnote-ref-16)
18. ‘A Shared European Policy Strategy,’ p. 3. [↑](#endnote-ref-17)
19. Conversations with PD leadership, February/March 2016. [↑](#endnote-ref-18)
20. Interviews with members of Jean-Claude Juncker’s cabinet, June 2016. See also James Politi, ‘How Italy Fell out of Love with the EU,’ *Financial Times* (16 March 2016). [↑](#endnote-ref-19)
21. This data was published by Eurostat on 6 December 2016. See, http://ec.europa.eu/eurostat/documents/2995521/7756312/2-06122016-AP-EN.pdf/2c2866b3-e369-4160-bca4-1238757bd740. [↑](#endnote-ref-20)
22. This data was published by Eurostat on 1 December 2016. See, http://ec.europa.eu/eurostat/documents/2995521/7752348/3-01122016-AP-EN.pdf/5f785386-b824-4b65-a09d-99d8bed9958a. [↑](#endnote-ref-21)
23. See ‘La battaglia con Juncker, per Renzi benefici politici e danni economici,’ *Il Sole 24 Ore* (16 January 2016); ‘Intesa Renzi-Juncker: “La flessibilità sui conti non va messa in discussione”,’ *Il Sole 24 Ore* (26 February 2016); James Politi, ‘EU Chieftains Bemoan European Disunity,’ *Financial Times* (6 May 2016). [↑](#endnote-ref-22)
24. See Federico Fubini, ‘Tensione tra Roma e l’Ue: Faccia a faccia Renzi-Juncker,’ *Corriere della Sera* (19 October 2016); Beda Romano ‘Manovra, scintille Juncker-Renzi,’ *Il Sole 24 Ore* (8 November 2016). [↑](#endnote-ref-23)
25. See ‘Annexes to the Communication from the Commission -- 2017 Draft Budgetary Plans: Overall Assessment,’ (Brussels: European Commission, COM(2016) 730 final, 16 November 2016) p. 4. [↑](#endnote-ref-24)
26. See ‘Schaeuble alla Ue: “Non controlla i bilanci e si rivolge al paese sbagliato”,’ *Corriere della Sera* (22 November 2016). [↑](#endnote-ref-25)
27. Mehreen Khan and Jim Brundsen, ‘Eurozone Calls on Italy to Redouble Budgetary Efforts,’ *Financial Times* (5 December 2016). [↑](#endnote-ref-26)
28. http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0059&from=EN. [↑](#endnote-ref-27)
29. See paragraph 82 of the BRRD. [↑](#endnote-ref-28)
30. See Poli-ti, ‘Eurozone Austerity Fanning Flames.’ See also James Politi, ‘Italy Bank Rescues Spark Bail-in Debate as Anger at Renzi Grows,’ *Financial Times* (22 December 2015). [↑](#endnote-ref-29)
31. See James Politi and Rachel Sanderson, ‘Renzi Faces Political Backlash over Italian Banks’ Rescue,’ *Financial Times* (10 December 2015). [↑](#endnote-ref-30)
32. Gianluca Paolucci, ‘I legami tra Banca Etruria e la famiglia Boschi,’ *La Stampa* (16 December 2015). [↑](#endnote-ref-31)
33. See, ‘Salva banche, provvedimenti per i risparmiatori: spunta un fondo di solidarietà,’ *La Repubblica* (4 December 2016). [↑](#endnote-ref-32)
34. For the definition of and explanation for Italian non-performing loans, see ‘La recente analisi dei prestiti deteriorati condotta dalla Banca d’Italia: principali caratteristiche e risultati,’ (Rome: Banca d’Italia, July 2013). See also Table 2.6 in the *Supplementi al Bolletino Statistico: Indicatori monetari e finanziari – Monete e banche* (Rome: Banca d’Italia, various issues). [↑](#endnote-ref-33)
35. These reforms are analyzed in greater detail in Manuela Moschella, ‘La riforma del sistema finanziario: una nuova governance per le banche popolari e le fondazioni bancarie,’ in Maurizio Carbone and Simona Piattoni, eds. *Politica in Italia 2016* (Bologna: Il Mulino, 2016) pp. 185-201. [↑](#endnote-ref-34)
36. See Claudi Gatti, ‘Bpm e le incognite sulla fusione con il Banco,’ *Il Sole 24 Ore* (23 November 2016). [↑](#endnote-ref-35)
37. For the text of the decree, see: <http://www.gazzettaufficiale.it/eli/id/2016/05/03/16G00076/sg>. The insights from the Renzi team are based on interviews conducted in May and June, 2016. [↑](#endnote-ref-36)
38. Fabrizio Massaro, ‘Esplora il significato del termine: Unicredit, ecco la lettera di garanzia sull’aumento della PopVicenzaUnicredit, ecco la lettera di garanzia sull’aumento della PopVicenza,’ *Corriere della Sera* (11 June 2016). [↑](#endnote-ref-37)
39. Federico Fornaro, ‘Popolare Vicenza e Veneto Banca. Tutte le angosce di Penati col Fondo Atlante,’ *Formiche* (27 June 2016). [↑](#endnote-ref-38)
40. The number of households exposed became apparent as MPS offered to convert subordinated debt into equity at full value. See ‘Mps: conversione per 11 bond, il 50% in mano a piccoli risparmiatori,’ *Il Sole 24 Ore* (16 November 2016). [↑](#endnote-ref-39)
41. See European press releases for February (http://europa.eu/rapid/press-release\_IP-16-279\_en.htm) and June (http://europa.eu/rapid/press-release\_IP-09-929\_en.htm?locale=en) 2016. [↑](#endnote-ref-40)
42. See the press release by MPS dated 4 July 2016 (http://english.mps.it/media-and-news/press-releases/2016/Pages/press\_release\_20160704.aspx). [↑](#endnote-ref-41)
43. Interviews in New York and London, July and November 2016. [↑](#endnote-ref-42)
44. For the text of the decree, see: http://www.gazzettaufficiale.it/eli/id/2016/12/23/16G00252/sg. [↑](#endnote-ref-43)
45. See, for example, Christopher Hill, Sara Silvestri, and Elif Cetin, ‘Il fenomeno migratorio e i problemi del multiculturalism in Italia,’ in Maurizio Carbone and Simona Piattoni, eds. *Politica in Italia 2016* (Bologna: Il Mulino, 2016) pp. 239-258. [↑](#endnote-ref-44)
46. The data for the country of embarkation is taken from the United Nations High Commissioner for Refugees (UNHCR). The most recent report as of this writing is found here: file:///C:/Users/ejone/Downloads/2016\_11\_Sea\_Arrivals\_Dashboard\_November.pdf. [↑](#endnote-ref-45)
47. See John Hooper and Ian Traynor, ‘Sarkozy and Berlusconi to call for return of border controls in Europe,’ *The Guardian* (25 April 2011). [↑](#endnote-ref-46)
48. This data is from UNHCR. See: http://data.unhcr.org/mediterranean/download.php?id=83. [↑](#endnote-ref-47)
49. Again, see UNHCR (http://data.unhcr.org/mediterranean/country.php?id=105). [↑](#endnote-ref-48)
50. See ‘Migranti, record di sbarchi nel 2016,’ *Il Sole 24 Ore* (6 January 2017). [↑](#endnote-ref-49)
51. Gavin Jones, ‘Italy’s Renzi steps up attack on EU, Merkel,’ *Reuters* (18 September). [↑](#endnote-ref-50)
52. https://www.whitehouse.gov/the-press-office/2016/10/18/press-conference-president-obama-and-prime-minister-renzi-republic-italy. [↑](#endnote-ref-51)