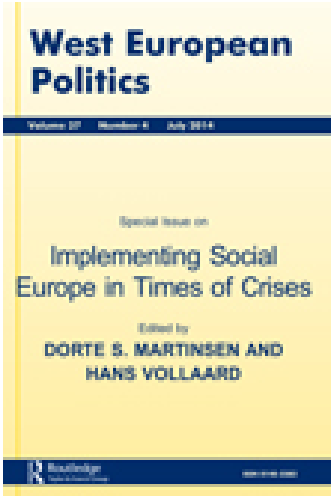

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Altered Europeanisation of Pension Reform in the Context of the Great Recession: Denmark and Italy Compared

CAROLINE DE LA PORTE and DAVID NATALI

This article analyses the Europeanisation of national pension systems in Denmark and Italy. Through the analytical framework of a 'two-level' game, it analyses pension reforms in the two countries, which, in the wake of the crisis, breached EU budgetary requirements, and shortly after reformed their pension systems. The EU affects pension reform in both cases, but in distinct ways. When Denmark's economy was financially vulnerable, the EU's excessive deficit procedure affected the decision to reform pensions indirectly, by triggering a rapid political decision to speed up a pension reform. By contrast, the Italian economy's critical vulnerability and the consequent risk for the whole Eurozone led to a situation whereby the European actors entered the domestic political scene and thereafter more forcefully induced reforms. The findings from the two cases show that the EU's role in pension reform has been significant during crises, but through interaction with domestic actors. Furthermore, from a theoretical perspective, the intervening variables – domestic and EMU vulnerability as well as EU and domestic politics – are crucial to understanding the reform decisions through two-level games.

The Great Recession which has weighed down on the European Union since 2007 has put pension systems under unprecedented pressure via the requirements for fiscal consolidation of the Economic and Monetary Union (EMU). The present article analyses the Europeanisation of national pension systems through the analytical framework of a 'two-level' game (TLG), which can accurately capture how EU–domestic interaction plays out in (domestic) reform decisions that are indirectly affected by EU budgetary requirements. We analyse pension reforms via the TLG in Denmark and Italy, which, in the wake of the crisis, breached EU budgetary requirements and shortly after reformed their pension systems. In the crisis context, the EU puts pressure on member states

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through economic policy coordination – the Stability and Growth Pact (SGP) – but also through conditionality and back-room diplomacy, which have thus far been neglected in the literature. Our findings are that the EU affects pension reform in both cases, but in distinct ways. When Denmark's economy was financially vulnerable, the EU's excessive deficit procedure (EDP) affected the decision to reform pensions indirectly by triggering a rapid political decision to speed up pension reform. By contrast, the Italian economy's critical vulnerability and the consequent risk for the whole Eurozone led to a situation whereby the European actors entered the domestic political scene and thereafter more forcefully induced reforms. The findings from our two cases show that the EU's role in pension reform has been significant during the crisis. Furthermore, from a theoretical perspective, the intervening variables are crucial to consider in assessing the reform decisions through the TLG.

The article is organised as follows. The next section presents the literature review, the analytical framework based on the TLG as well as the hypotheses centred on vulnerability. It also discusses the methodology used and case selection. We then analyse the TLG of pension reform in Denmark and Italy, in the 2009–11 period. For each case, we present the core features of pension politics (the role traditionally played by the domestic and EU actors) as well as institutional and policy features of the pension systems, focussing on the reforms undertaken in 2011. This is followed by an analysis of EU–domestic games. To conclude the article, we discuss the empirical and theoretical implications of our findings, which point to more EU involvement in welfare state affairs in a crisis context.

Europeanisation of Pensions Policy: Towards a Dynamic and Comprehensive Two-level Framework

EU governance is comprised of legislative and non-legislative instruments that address a range of social policy issues. Concerning core redistributive areas, instruments range from economic policy coordination with benchmarks, high surveillance and possibly sanctions in the case of non-compliance, to softer policy learning around innovative ideas. In line with the contested nature of Social Europe (Martinsen and Vollaard 2014), we here refer to the EU's indirect pressure on national social policies, especially the Maastricht convergence criteria (Leibfried 2010). Economic governance, especially for members of the Economic and Monetary Union, has been central at EU and domestic levels in the crisis context (Armstrong 2013).

Analytically, we concentrate on the descending stage (implementation) of Europeanisation that has been conceptualised through two alternative analytical perspectives: 'top-down' and 'bottom-up' (Exadaktylos and Radaelli 2009). From the 'top-down' perspective, Europeanisation is identified as a process that generates adjustment pressure on member states, which is mediated by domestic institutions and actors. This literature has identified the degree of domestic-level misfit with EU legislation as a key determinant for potential

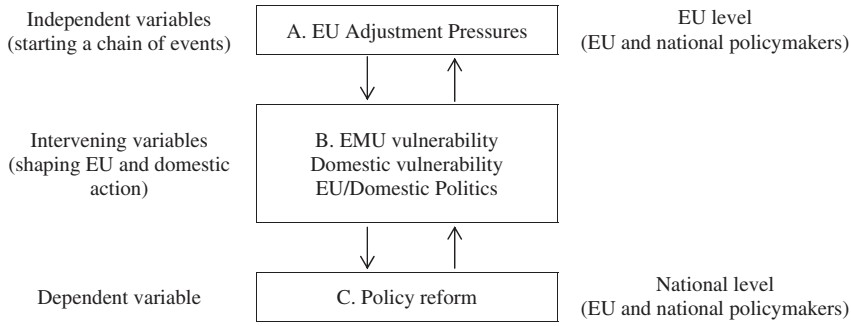
change, considering a higher degree of misfit as a necessary but not sufficient condition for change (Schmidt 2002). This perspective has been adapted over time, with new empirical knowledge about the actual influence of EU legislation in member states with distinct political cultures. The top-down perspective thus moves closer to considering the domestic level, since it maintains that the EU's influence is determined by different national practices of compliance: 'national cultures of appraising and processing adaption requirements' (Falkner *et al*. 2007: 404). By contrast, the 'bottom-up' perspective begins at the domestic level and identifies the EU as one possible source of influence, alongside many other competing factors (Stolfi 2008). In this view, reforms are largely determined by domestic politics and actors, while EU pressures intervene in a complex process of change. The EU's influence is not understood in terms of its initial degree of 'fit' with European policies, but rather according to how domestic agents or politicians make use of the EU in terms of strategic aims or new ideas.

While this knowledge is relevant, there are two shortcomings for our case. First, both 'top-down' and 'bottom-up' frameworks are static, which is not really suited to the *changing aims* of EU governance (Armstrong 2010). The assumption of both approaches is that the EU pressure for change is constant and mainly descending, which is not the case for pensions policy, which is influenced by changing circumstances. The EU's formal requirements may change because existing instruments are strengthened and new instruments are introduced (Verdun 2013). But even if formal requirements are not altered, actual EU pressure on member states may change due to the increased economic and budgetary problems of an individual economy. Second, traditional frameworks do not take account of the iterative nature of policy coordination. Europeanisation literature does not fully consider how EU actors, under critical circumstances, may intervene in domestic politics, even in areas of national sovereignty, such as pensions policy. Furthermore, domestic actors are regularly present at domestic *and* EU levels of governance. The analytical implication is that it is necessary to select a dynamic framework to take account of these alterations *and* the interaction between EU and domestic levels of governance in a crisis context.

In the following, we delineate the main features of the TLG framework and explain how it is operationalised for our case: the Europeanisation of pensions policy through economic governance in the wake of the crisis (see Figure 1).

We use the TLG as a heuristic device to assess the weight and interaction of the EU and national actors and levels of governance in the reform process. Putnam (1988) developed this innovative framework to address the reciprocal influence between domestic and international affairs, where policy-makers strive to reconcile national and supranational imperatives. EU scholars have seen the relevance of the model for EU politics theoretically, but surprisingly there have been few attempts to actually use the approach for empirical analyses (Büchs 2008). We adapt the framework to the study of reform processes

FIGURE 1
EUROPEANISATION THROUGH A TLG IN THE WAKE OF THE CRISIS



involving EU and domestic levels of governance. In the original framework, developed in the field of International Relations, the main actors were domestic and moved in both 'game boards' (or levels of governance). The international level was not deeply involved in a country's policy process, differentiating it from the EU, which controls monetary policy for the EMU members and pressures the other (non-Eurozone) countries to reach or to comply with the convergence criteria. This means that not only domestic, but also EU actors can be involved in both game boards, making the TLG an even stronger device for the EU context than for the international context. We put particular emphasis on how economic and institutional circumstances influence reform processes that we capture with conceptual modifications to the model, regarding the variables 'domestic vulnerability' and 'EMU vulnerability', which will be explained below.

EU Adjustment Pressures

Looking at economic governance, 'EU adjustment pressures' include formal procedures of conditionality and backroom diplomacy. These pressures have provided EU-level actors with leverage to push through reforms during the *Great Recession* (Sacchi 2013). The first adjustment pressure is comprised of formal procedures, namely policy coordination under the SGP and strengthened surveillance in the case of an EDP. The EDP is triggered at the EU level, but both EU and domestic actors – this may alter depending on circumstances – play a role in suggesting which reforms to undertake. The literature has thus far underemphasised the fact that domestic (political and administrative) actors are active in negotiating which reforms to implement, by communicating information about the reform decisions and implementation to the EU in regular follow-up reports. Another aspect concerning the formal procedures is that EU adjustment pressures may alter. In 2010, the SGP was strengthened by increasing member state accountability and by increasing automaticity of EDPs and

sanctions in the case of non-compliance. All this is now being coordinated in the 'European Semester'[1] (ES) (De la Porte and Heins 2014). Conditionality is a second type of EU adjustment pressure of major importance for pensions during the crisis. This instrument consists of financial help provided by the EU (and other international organisations and member states) in exchange for structural adjustments (including curbing public expenditure in pensions). Conditionality has been used for those member states most in trouble from an economic and/or budgetary point of view and has been institutionalised as the Outright Monetary Transactions (OMT) programme launched in 2012 (Begg 2013). A third EU adjustment pressure is 'backroom' diplomacy, which refers to informal negotiations used by the EU and the most powerful member states to convince domestic policy-makers to introduce the reforms proposed by the EU in order to tackle major challenges and problems (e.g. the sovereign debt crisis).[2]

Vulnerability and Politics

While the TLG focuses on the interaction between the EU and domestic levels and actors, the intervening variables are often secondary. Our approach is to highlight these variables, especially those linked to economic circumstances, as the intervening variables are decisive for when, how and with what results EU and domestic actors interact in a reform process. The first intervening variable we conceptualise is *EMU vulnerability*, which is when the EMU and the single currency are threatened by one country's economic and budgetary conditions (i.e. the threat of a sovereign debt crisis). The second intervening variable is *domestic vulnerability*, that is when an individual country's financial and budgetary situation leads to more stringent pressure (e.g. an EDP), but where domestic actors perceive a need to undertake reforms to gain confidence from the financial markets. The third intervening variable comprises *EU and domestic politics*, which refers to (conflicts of) interests between member states' governments and EU institutions, as well as between political parties and institutions at the domestic level. These three intervening variables, in turn, affect EU adjustment pressures upstream and policy reform processes downstream.

Policy Reforms

The EU adjustment pressures together with vulnerability and politics influence *policy reforms* at national level (the dependent variable). We are particularly interested in how the EU pressures and intervening variables affected the decision to enact pension reform. We consider that successful policy reforms (which contribute to reducing the budget deficits and the public debt) may decrease EU adjustment pressures, while reforms that are not carried through due to domestic politics may increase adjustment pressures.

We assess the Europeanisation of pensions policy through the TLG framework described above. We develop two hypotheses about how the policy reform process has been altered throughout the crisis:

Hypothesis 1: EU influence on welfare state reform is likely to increase under conditions of domestic vulnerability.
Hypothesis 2: In a context of EMU vulnerability, the EU's influence on welfare state reform is likely to increase.

By applying the TLG to analyse pension reform in the crisis context, we can assess whether, and if so how, Europeanisation has been altered during the crisis.

To carry out our analysis, we use an interpretative research methodology that involves putting together the evidence about a phenomenon (the role of the EU and domestic actors and levels of governance in pension reform) through process-tracing (Collier 2011) in a way that is sensitive to chronological evolution. But it is also deductive, since a causal analytical research design is developed around the issues of domestic and EMU vulnerability. The primary data comprises EU and national official documentation and in-depth semi-structured expert interviews.

Denmark and Italy are analysed as they are different cases: Denmark has always implemented and followed EU legislation, i.e. it belongs to the 'world of law observance'. Italy has had a mixed record in which domestic politics often leads to policy inertia. Italy belongs to the 'world of domestic politics' (when looking at transposition) and to the 'world of dead letters' (when looking at enforcement and application) (Falkner *et al.* 2007). There are also other particularities: Denmark is only a partial member of EMU due to an opt-out on the common currency, even if the Danish national bank voluntarily follows a strategy whereby the Danish kroner is pegged to the euro. Therefore, Denmark follows the SGP and takes steps to follow the EMU convergence criteria in regular 'convergence programmes'. Both can come under EDP, although Denmark cannot be formally sanctioned if it does not follow the actions to correct the excessive deficit. Italy, by contrast, is a full member of EMU, and must continue to respect the EMU criteria. Denmark came under an EDP in the spring of 2010 and decided to reform the early retirement system in the spring of 2011. Italy came under EDP in the winter of 2009 and passed a reform in December 2011. The contingent circumstances of the two cases are similar, enabling us to test the two hypotheses about domestic and EMU vulnerability as key factors when explaining the decisions to undertake pension reform.

The next two sections present the two case studies. In each, we first shed light on the core features of pension politics, institutions and policy. We then present the most recent reforms introduced in the two countries, in the wake of the crisis, and then analyse the EU-domestic games around these reforms. If we find evidence for our hypotheses, then we assume that the empirical implications may be similar for other cases.

Denmark

Danish Pensions Politics and Policy

Denmark belongs to the 'world of law observance', where following the law – be it initiated nationally or from the EU – is not questioned (Falkner *et al.* 2007). Politicians and civil servants consider it necessary to implement EU requirements, while adapting these requirements to fit domestic priorities (Martinsen 2005). However, when it comes to pensions policy, the picture is a bit different: Danish politicians *and* civil servants believe that the EU should not intervene in redistributive areas, such as pensions. Pensions policy has always been decided through domestic politics, on the basis of political party coalitions and labour market organisations. Danish experts, the Economic Council and various national commissions provide analyses and ideas about reforming pensions (Kvist 2012). The recommendations from the OECD in pensions and other areas have always been very highly valued by Danish civil servants (Interview Danish Ministry of Health and Prevention 2010). By contrast, until Denmark came under EDP in 2010, suggestions from the EU level were not considered as seriously (Interview Danish Finance Ministry 2013).

Denmark has a multi-pillar pension system. The first pillar, the national old age pension, comprises a basic and a supplementary amount, which is universal and tax-financed on a pay-as-you-go basis. During the 1990s, there was a rapid expansion of fully funded (second pillar) earnings-related pensions in collective agreements that have gradually become more significant in terms of income replacement, compared to public pensions (Kvist 2012). The third pillar is the private pension plan, which is fully funded through private contributions, and is still just of minor importance. The voluntary early retirement (VER) (*efterløn*) scheme has a key role in the system. It was introduced in 1979, and was intended to be used mainly by workers who were worn down by physical labour. However, the scheme was used far more than originally intended and has become a great financial burden for Danish public finances, as highlighted by Danish and international experts (including the OECD) throughout the 2000s. In 1998, the Prime Minister Poul Nyrup Rasmussen suggested reforming the VER scheme. This was contrary to the pledge he had made in the run-up to the election, which was to maintain the scheme. Due to this suggestion, he lost the following election in 2001 and the issue of dismantling the VER was not discussed again until the financial crisis that started in 2007 (Abrahamson and Wehner 2003; Kvist 2011).

To respond to the challenge of ageing populations, putting pressure on the pension system's financial sustainability, a major welfare reform was decided and carried out in 2006. The overarching goal of the reform was to increase labour supply to bear the increasing costs of the welfare state. This included the VER reform, increasing the age of access to the scheme from 60 to 62 years. It also included increasing the general retirement age (from 65 to 67 years between 2024 and 2027), and introduced a demographic adjustment of the retirement age to life expectancy, which are both intended to increase

the labour market participation of older workers. The reform was intended to address the challenge of rising costs of pension schemes due to ageing populations while also maintaining living standards during old age. The reform was passed by the Liberal–Conservative coalition government, when Anders Fogh Rasmussen was Prime Minister. It was accepted by labour representatives as well as the opposition parties because it was part of the broader 2006 welfare reform package aiming to modernise the welfare state.

The 2011 Retirement Reform

On 13 May 2011 a new retirement reform was decided, whereby the reform of the voluntary early exit scheme was to be intensified in order for it to be phased out entirely. The 2011 reform was agreed under the coalition Liberal–Conservative government, with the support of parties in the government and in the opposition.[3] Following the election of September 2011, a new governmental coalition of the Social Democrats, Socialists and the Social Liberals was formed. The reform was formally passed under this new governmental coalition on 21 December 2011 (Kvist 2012).

The measures in the 2011 reform consisted first of implementing the decision to increase the retirement age from 65 to 67 faster, so that it starts in 2014, rather than in 2019. The other measures concerned the VER scheme: the further increase of the legal age to accede the voluntary early exit (from 62 to 64) and a reduction of the benefit period for early exit benefits (from five to three years). To facilitate the dismantlement of the scheme, persons having paid contributions to the scheme would be able to receive the benefits paid out tax free if they left the scheme (Kvist 2011). To replace it, a new 'senior disability pension' was passed in January 2013 for people with health problems – although entitlement was tougher – that were no longer entitled to the VER scheme. All in all, these reforms do address the challenges facing costly welfare states. The Finance Ministry has calculated that this reform would improve public finances by DKK18 billion in 2020 and would strengthen the sustainability of public finances with DKK10 billion, equal to 0.5 per cent of GDP, by 2020. The Finance Ministry also projected that this reform would lead to higher employment rates and an increase in wealth (Kvist 2011). However, the system is becoming more unequal as well (Kvist and Greve 2011). The following section analyses what role EU pressure as well as the intervening variables played in the process of phasing out VER from the welfare reform of 2006 to the Retirement Reform agreed on 13 May 2011.

Analysis: EU–Domestic Interaction via a TLG

The economic and financial crisis that began in 2007 was particularly acute in Denmark from 2009 onwards, with low growth and high unemployment (Table 1). This led to an intense domestic debate about fiscal consolidation and

TABLE 1
KEY ECONOMIC AND SOCIAL INDICATORS FOR DENMARK AND ITALY

Year	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
Countries			**Denmark/Italy**			
Change in GDP growth	1.6/1.7	−0.8/–1.2	−5.7/–5.5	1.6/1.7	1.1/0.4	−0.4/–2.4
Debt/GDP	27.1/103.3	33.4/106.1	40.7/116.4	42.7/119.3	46.4/120.8	45.6/127
Employment rate older workers (55–64)	59/34	58/34	58/36	58/37	60/38	61/40
Unemployment rate	3.8/6.1	3.4/6.7	6.0/7.8	7.5/8.4	7.6/8.4	7.5/10.7

Source: Eurostat.

re-launching growth, including an EU–domestic game around an excessive deficit.

The first move in the EU-level game, following the rules, was by the European Commission. On the basis of the Danish report of April 2010, the Commission presented a report on the existence of an excessive deficit in Denmark in May 2010.[4] The Commission assessed that although the breach of the excessive deficit criterion was deemed to be 'exceptional', it was considered to be long-term. Denmark was therefore domestically vulnerable. However, the Commission also underlined that the long-term budgetary impact of ageing in Denmark would be lower than the EU average and that the risks associated with the sustainability of Danish public finances were low (European Commission 2010a). The Danish authorities, in turn, presented Denmark as having a strong track record of sound public finances, including consolidating public finances in good times. Both EU- and national-level actors present Denmark as a good pupil at the EU-level game board.

Parallel to this EU–domestic game around the forecast excessive deficit, the Danish government presented a plan to exit the crisis (*Genopretningspakken*) in the national game board in May 2010. In the discretionary plan, the government stated that Denmark should enact reforms in order to avoid the risk of a sovereign debt crisis. The crisis plan also highlighted that Denmark should live up to the expected EU recommendation in the EDP, in order to re-boost market confidence in the Danish economy. The measures proposed to achieve fiscal consolidation included the suspension of automatic indexation of welfare transfers, including for the public pension, as well as a major labour market reform. Following fiscal consolidation, the government planned further reforms, in particular the further reform of the VER scheme, but the details were not laid out at the time.

Secondly, in the European-level game board, the European Commission prepared its (expected) opinion on the existence of an excessive deficit in Denmark in June 2010 (European Commission 2010b) and the Council issued its recommendation to Denmark with a view to bringing an end to the excessive government deficit in July 2010. The EU assessed that the Danish

economy was domestically vulnerable due to the crisis, but also that it was possible, with some reform measures, to address the problem. Contrasting with the Italian case, the Danish vulnerability was not critical for the EMU as such. Denmark was thus recommended to implement measures necessary to achieve the correction of the deficit by 2013.

In the domestic-level game, the issue of dismantling the VER was on the agenda as of mid-2010 in the plan to exit the crisis. However, it was not until the beginning of 2011, in the Prime Minister's politically symbolic New Year's speech, that the phasing out of VER was fully spelled out. Throughout the speech, the Prime Minister emphasised that Denmark needed to illustrate that it was economically responsible (thus countering the situation of domestic vulnerability) by carrying through this reform. The Prime Minister specified that:

> The government therefore suggests to incrementally overhaul the early retirement scheme … For all of you that are under 45 years of age, we suggest that the early retirement scheme be dismantled entirely […] for people who go on early retirement because they are tired and worn down, they will still have the possibility to go on early retirement. This is the overall framework for the planned early retirement reform that the government will present later in January.[5] (Rasmussen 2011)

In January 2011, the reform was formally proposed, but had not yet been approved by parliament.

Third, in the European-level game, the Danish Finance Ministry provided the information to the Commission on action taken in order for Denmark to fulfil the recommendations of the EDP in January 2011. The Commission underlined that one of the key measures regarding the welfare state was the shortening of the period for receiving unemployment benefits. The Commission concluded that 'Denmark has taken action representing adequate progress towards the correction of the excessive deficit within the time limit set by the Council … the Commission considers that no further steps in the EDP of Denmark are needed at present'. The Commission also noted that the phasing out of the VER had been proposed by the government (European Commission 2011a). In March 2011, Lars Løkke Rasmussen participated in the annual spring council of the European Union, where he pledged to his European peers that Denmark would reform its early retirement scheme. This was met with scepticism on the domestic front, as political agreement in parliament had not been reached on this decision. In particular, the Social Democratic Party and the Socialist Party were skeptical about the reform (Notat 2011). The Finance Ministry noted that the EDP indirectly affected the decision to overhaul the early retirement scheme, by enabling the political parties to agree more quickly on the reform. The EDP, which Denmark was under until 2013, 'matured' the decision to dismantle the early retirement system – a decision which had been in the pipeline for a long time, but had previously been too sensitive to be

undertaken (Interview Danish Finance Ministry 2013). At the domestic level, the political decision to pass the reform was not taken until May 2011, under the Conservative–Liberal government. It was then implemented by a new coalition government comprised of the Social Democratic Party, the Socialist Party and the Social Liberals after the September 2011 elections. The formal decision to implement the reform was taken under this new governmental coalition on 21 December 2011.

In the following Commission analyses on Danish reforms, the reform of VER was mentioned briefly with regard to its overall contribution to exit the excessive deficit, alongside other measures. It is to be noted that in the first country-specific recommendations of the annual growth survey, that launches the yearly European Semester, no recommendation on pensions was made to Denmark. Indeed, pension reform had already been undertaken and was therefore no longer considered to be a pressing challenge. In 2013, Denmark was no longer in excessive deficit, due in large part to its own national plan to exit the crisis, showing that it indeed is financially responsible, as underlined by the Commission and by Danish authorities during the two-level game.

Analytical Assessment

In the Danish case, EU pressure intervened in the decision to undertake the dismantlement of the VER because the EDP highlighted the deficit problems of the Danish economy. In line with hypothesis one, *domestic vulnerability* was a necessary intervening variable for the decision to reform the VER more rapidly and more radically than originally planned in the 2006 reform. The 2011 VER and pension reform, but also the labour market reform, were, however, mainly carried out due to the domestic concerns about low growth, high public debt and a high budget deficit, as well as high unemployment. The EDP is one of the consequences of the financial crisis on Denmark, which contributed to passing sensitive reforms, which would not otherwise have been possible politically.

Italy

Italian Pensions Politics and Policy

Italy has a politicised transposition of EU requirements, together with poor enforcement and application. Each EU initiative gets assessed on the basis of a fresh cost–benefit analysis. Non-compliance is probable when there is a contradiction between EU requirements and domestic interest politics.

By contrast, the EU has played an important role in the pension field. The EMU criteria have acted as an effective exogenous constraint, where EU influence can be considered as a necessary condition for introducing cutbacks to public pensions (Jessoula 2012). Yet pension reform has been a complex and risky political enterprise, with a lively debate between a parliamentary majority

and opposition, together with social partners. Despite EU pressures, some reform proposals did not pass – notably the Berlusconi reform proposed in 1994 – while others were watered down. This confirms that Italian reform decisions have been in the hands of domestic politicians.

From a policy perspective, Italian pensions are a typical example of the social insurance pension model, where the state provides the greater part of pension benefits through public earnings-related schemes financed on a pay-as-you-go basis. The unusually high generosity and coverage, and the encompassing character of public pensions, limits the role of supplementary pension funds. While Italy shares these traits with other European countries (e.g. France and Germany), some peculiarities have characterised the system in the last decades. Italy has been one of the highest-spending EU countries: in 2007, total public spending on pensions was above 14 per cent of GDP. With regard to public finances, Italy has long had a persistently high level of public debt (well above 100 per cent of GDP and a deficit around the 3 per cent target set by the EU) (Table 1). This led in the past to the activation of EDP against Italy (Natali 2011).

Since the 1990s, reforms have radically transformed the system, with a move to a (still incomplete) multi-pillar pension model (with the reduction of public pensions and greater room for private funds). Despite such an impressive reform record, financial strains and low employment rates have represented an Italian peculiarity contributing to putting the system's sustainability at risk, in the context of population ageing.

Looking back at the last decades of reform, seniority pensions have been a key issue at the core of the debate. These are benefits calculated on the basis of the years of contribution, and are payable before the legal retirement age. They are extremely popular and widespread and are biased towards a lower effective retirement age (at odds with the aim of activating older cohorts of workers). They have been one of the targets of reformers to contain public spending, but have always been at the origin of political conflicts (between political parties and social partners). The Berlusconi Government of 1994 resigned because of the massive political and trade union opposition to the proposed cutbacks of seniority benefits. Most recent reforms passed in 2004 and 2007 did not dismantle such benefits while they introduced further cutbacks and instigated the rapid development of supplementary pension funds (Jessoula 2012).

2011 Pension Reform

With the Great Recession and the mounting budgetary tensions, Italy became extremely vulnerable, leading some politicians at the crossroads between domestic and EU game boards to take radical reform decisions. A new technocratic government – led by Mario Monti, former EU Commissioner for Competition – was voted in by the parliament in November 2011 and supported by a vast parliamentary majority. Within a month the new government approved a €30 billion austerity plan. The 'Save Italy' decree was an attempt

to control public spending and to rapidly reduce the national debt, including measures on pensions. All this was consistent with the detailed measures proposed by the ECB in August 2011, which will be described below.

Law Decree 201/11 (December 2011) introduced major changes, in particular a move towards a single retirement age for men and women (66 years and 7 months by 2018), for employees in both the public and private sectors, and for the self-employed, as well as a flexible retirement age, encouraging people to work longer, and a temporary stop to indexation. The periodic adjustment of the retirement age, in line with increases in average life expectancy, was to take place between 2013 and 2019. Eventually, from 2012, it was decided to implement the defined contribution pension scheme introduced in earlier reforms, thus replacing the earnings-related defined benefit scheme. What is more, the seniority pension was eliminated. Accordingly, the reduction of public pension expenditure in terms of GDP was deemed to be 0.2 percentage points in 2012, 0.9 in 2015 and 1.4 in 2020 (Jessoula and Pavolini 2013).

Analysis: EU–Domestic Interaction in the Shadow of the Crisis

In December 2009, Italy was subject to the EDP: according to the Italian government, the deficit/GDP ratio for 2009 was expected to be 5.3 per cent (well above the 3 per cent limit) with a debt/GDP ratio of over 115 per cent. As in Denmark, the EDP represented the first *adjustment pressure*. In its report on the existence of excessive deficit, the Commission (2009) was of the opinion that, thanks to the pension reforms adopted, the long-term budgetary impact of ageing in Italy would be lower than the EU average. However, the Council (2010) stressed that 'pension expenditure as a share of GDP remains among the highest in the EU' and that 'the projections hinge upon the assumption that the adopted reforms are fully implemented'. Thus, Italy's past record cast doubt on its institutional capability and political will to follow through on implementation.

At the national game board, in May 2010 the Italian government produced the Combined Report on the Economy and Public Finances with a set of measures to reduce the deficit and contain public debt, including a postponement of access to retirement by some months for those meeting the age/seniority eligibility conditions.

Afterwards, the first AGS of January 2011 underlined that, for the members of the Eurozone, fiscal consolidation should be supported by reforms to increase the long-term sustainability of pension systems. However, the future financial sustainability of Italian pensions was not at the top of the EU agenda, as proved by the lack of any reference to pensions in the Country Specific Recommendations (CSR) of 2011 (Council 2011).

The adjustment pressure, consistent with EDP and CSR, was thus weak, as confirmed by the Ministry of Economy: 'up to July 2011, the Italian government decided to wait for the end of the crisis: neither major investments to

re-launch economic growth nor major cutbacks were foreseen. Such a strategy was in line with the EU demands' (Interview Italian Economic Minister 2013). Thus, the delayed approach to Italy's excessive deficit was implicitly accepted by the EU actors.

Yet in the summer of 2011 the EU made a more explicit demand for reform. Domestic vulnerability was enhanced, especially when the sovereign debt crisis that originated in Greece spread across the EU periphery (Ireland and Portugal). Global financial markets then perceived Italy to be the weakest part of the Eurozone. Investors saw a higher risk associated with investing in Italian bonds and demanded a higher return to compensate for taking such a risk. This further contributed to Italy's economic and fiscal *domestic vulnerability*. The 'spread' (the gap between the interest paid by the German government and that paid by Italy in order to obtain funds on the financial market to sustain the public debt) increased steadily during 2011 (Jessoula and Pavolini 2013). A full-blown crisis in Italy – the third most indebted nation in the world – could have had a devastating effect, and, as stressed by a commentator, 'if investors drove Italy's borrowing costs to unsustainable levels, it would imperil the entire European monetary union (increased *EMU vulnerability*).

At the EU level, the ECB reacted to the Eurozone debt crisis by expanding its remit beyond monetary policy. In early August 2011, the ECB announced a plan to purchase Italian government bonds in order to keep yields under control. Even though Italy did not demand financial aid and did not sign any memorandum of understanding, conditionality was nevertheless introduced. On 5 August 2011, the ECB together with the Bank of Italy sent a letter to the Italian government. Mr Trichet (President of the ECB) and Mr Draghi (Governor of the Bank of Italy and future President of the ECB) set out a precise course of action focused on measures to promote growth and to balance the budget by 2013 – a year earlier than the Italian government had planned. Among the measures envisaged, the two governors asked for a new pension reform 'making more stringent the eligibility criteria for seniority pensions and rapidly aligning the retirement age of women in the private sector to that established for public employees, thereby achieving savings already in 2012'. The letter set a 30 September deadline for legislation to be adopted.

The unprecedented letter was informal but contained extremely stringent pressure (in terms of reform outputs and regulatory instruments to use), thus representing de facto conditionality. While Trichet denied direct conditionality, the bank began a controversial operation to buy Italian bonds. The letter is an unprecedented example of a TLG between EU and national institutions, the ECB and the Bank of Italy. The latter used the European-level game and played 'a key role in setting a very detailed list of reforms to pass'. Moreover, the letter came at the end of a domestic political struggle where 'the President of the Republic and the Bank of Italy represented two institutions that tried to restore the country's credibility and to condition domestic politics' (Interview Italian party leader 2014). Thus, national policy-makers and technocrats in favour of more stringent rules for retirement used the critical budgetary crisis to pass them.

At the domestic level, just after the letter, the Berlusconi government announced a consolidation package of €54 billion. After lengthy negotiations within the right-wing majority, in September 2011 the government introduced measures on pensions, concerning eligibility conditions for both old age and seniority pensions as well as the rules to calculate benefits. Yet the Northern League (part of the parliamentary majority) vetoed any major reform of seniority pensions. The role of domestic-level politics in Italy still plays out at this stage according to its traditional attitude towards implementation of EU prerogatives. The EU deemed the reform package insufficient and pressure subsequently became even greater.[6] This was due to EMU vulnerability and the risk of a sovereign debt crisis.

More pressure came from more 'backroom' interventions from Eurozone leaders. When it was clear that despite the unprecedented letter from the ECB and the Bank of Italy, domestic policy-makers were not able to pass radical measures on pensions, employment and budgetary policy, European leaders further increased pressure. This was the case of the Franco-German leaders who became very active in addressing the Italian crisis. The two leaders started to ask the Italian President of the Republic about the country's credibility and – as stressed by international commentators – were suspected of engineering Mr Berlusconi's departure As stressed by Fusaro (2012), the President of the Republic became the key political actor looking for an alternative to Berlusconi. In November 2011, in a context of mounting doubts among the European leaders and the parliamentary vote against the 2010 public finances, the head of state asked the Prime Minister to resign and consulted the parliamentary groups to form a new government, importing a technocrat from Brussels to the Italian domestic gameboard. As stressed by an Italian policy-maker, 'the then Prime Minister Mario Monti who substituted Berlusconi had no particular visibility and legitimacy in Italian politics. Yet legitimacy was provided by foreign capital, the ECB and the Commission' (Interview Italian party leader 2014).

Here we see further proof of the TLG, where EU leaders 'go to Rome' and intervene in the domestic politics, while national political actors worked on a new government coalition. These mounting tensions led Berlusconi to resign in November 2011. A new technocratic government, headed by Monti, was set up and proposed an agenda largely inspired by the ECB letter. This is an unprecedented twist of the TLG, showing how the EU-level actors can effectively enact reform in a member state. Yet domestic political dynamics – e.g. the active role of the head of state and the Bank of Italy – were still extremely relevant. The technocratic government successfully passed a pension reform eliminating seniority pensions. Parliamentary opposition and social partners were bypassed, while trade unions were not even informed of the reform content.

Analytical Assessment

In Italy the reform of seniority pensions, which was impossible in the previous decade, was pushed because Italy and the EMU as a whole became vulnerable.

Since the EDP did not effectively trigger reform, other mechanisms were used. The letter sent to the Italian government in the middle of the crisis was in fact jointly written by the President of the ECB and the Governor of the Bank of Italy in a TLG, where European actors become more active in domestic Italian politics while domestic institutions played their role at the EU level. At the same time, the incapacity of domestic policy-makers to tackle the crisis aggravated domestic vulnerability. But, due to the traditional problems in complying with EU requirements, domestic leaders still resisted passing reforms. In line with hypothesis two, when domestic problems put EMU at risk, Eurozone leaders intruded in Italian domestic politics. They supported a political turnover by legitimising technocrats to pass reforms.

Conclusion

The comparative analysis of Danish and Italian pension reforms of 2011 illustrates how the Europeanisation of pensions policy was enhanced in the shadow of the crisis through a TLG. We found evidence for both our hypotheses about domestic and EMU vulnerability, which signifies that during the Great Recession the nature of the EU-domestic level game in core re-distributive areas has been altered. The EU–domestic TLG around the EDP in Denmark was in step with its characterisation from the world of law observance, where domestic politicians aimed to reassure financial markets. The EU-level pressures triggered rapid political decisions to undertake welfare state reforms, where the plans for pension reform were launched at the domestic and EU game boards prior to domestic political consensus, due to domestic vulnerability. In the Italian case – that is, at the crossroads between the 'world of domestic politics' and the 'world of dead letters' – the TLG played out differently. The TLG around the EDP did not lead to a long-awaited pension reform, after which Italian domestic vulnerability rolled into EMU vulnerability, which put the Eurozone at risk. This led to an unprecedented situation whereby a government led by a technocrat was formed in order to enable reforms devised at EU level to be implemented in Italy. This puts a new twist on the TLG, where reform plans take place at the EU- rather than the domestic-level game board, after which they are decided and implemented domestically. Analytically, we have shown that even in the context of the crisis, more stringent EU adjustment pressure was the result of an iterative process, where EU and domestic actors interact at the EU- and national-level game boards.

From a theoretical perspective, the TLG represents an important analytical device to shed light on the complex interplay between European and domestic actors and levels of governance. Our empirical evidence shows that the intervening variables – domestic and EMU vulnerability as well as EU and domestic politics – have been crucial to capture EU–domestic interactions in a policy reform process. The TLG is flexible enough to capture the case of domestic-based pension politics, as in Denmark, as well as the case of Italy, with more explicit EU-level intrusion in a formerly domestic-based game. The empirical implications from our case studies are that the indirect pressure on national

policies in a contested Social Europe has increased during the crisis and that welfare reforms in core redistributive areas have been enhanced.

Notes

1. In 2010, the 'European Semester' was developed in order to coordinate *ex ante* the budgetary and economic policies of member states *and* to increase coherence among different policies. EU-level discussions take place on a broader palette of policy areas compared to before the crisis: macroeconomic imbalances, financial sector issues and structural reforms. The European Semester is launched by the European Commission (directorate-general of economic and financial affairs) via an Annual Growth Survey (AGS) after which country-specific recommendations are made to member states on the basis of a DG ECFIN proposal that must be approved by economic and financial affairs council and then endorsed by the European Council.
2. A sovereign debt crisis is a term coined in 2010 which refers to the perseverance of a recession that has made it difficult or impossible to refinance debt without assistance.
3. Anders Fogh Rasmussen of the Liberal Party was Prime Minister from 2001 until April 2009, after which Lars Løkke Rasmussen, also from the Liberal Party, took over the post.
4. The Danish government forecast a budget deficit for 2010 of 5.4 per cent of GDP, while the government gross debt was estimated at 45.1 per cent of GDP, below the maximum reference value of 60 per cent, but on a rising trend.
5. Own translation
6. In November Commissioner Olli Rehn (Vice-President of the Commission) sent a letter containing a list of additional measures in order to reach the target of budgetary balance in 2013.

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