

## Prodi's Government: First Steps at Home and Abroad

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After five years of political marginality within the EU, and few international benefits from divisive foreign policy choices, Italy after Silvio Berlusconi seems eager to restore its traditionally pro-European stance, starting with its withdrawal from Iraq. While Romano Prodi's credentials in this respect leave no room for misinterpretation, what loom on the not so distant horizon are the country's economic challenges. The question is whether the left-wing coalition, headed by the former President of the European Commission, will be able to deliver, and what should be realistically expected from it.

### A Series of Successful Electoral Appointments for the Prodi-led Coalition

Italy has recently experienced a turnover of its political personnel, both with the general elections which took place on April 9–10, as well as after the local elections at the end of May.

In both cases, the centre-left coalition (Unione), led by Romano Prodi, celebrated victory. The third relevant political event—the referendum on the constitutional reforms written by the previous Berlusconi-led government—saw a high turnout (more than 53% of the electorate), with a majority above 60% voting against the proposal. The reform would have pushed for a further decentralisation of power and authority, as was strongly requested by Umberto Bossi's Northern League, in exchange for the party's unwavering support of Berlusconi during the previous legislature.

The row following the electoral defeat is straining the right-wing coalition's balance of power. Both the Catholic party Udc (Christian Democrats) as well as the Northern League are increasingly looking tactically at Prodi for potential deal-making on selected dossiers.

The nine-party coalition led by Prodi has declared its desire to introduce reforms together with the opposition, but the decisive result of the referendum might have complicated matters rather than just boost the new government.

As a matter of fact, some of those who voted "no" to the proposed changes to the 1946 Constitution would not rule out the possibility of reforming some parts of it, while others are against any change. This makes it more difficult for the PM to strongly urge the need to work together across partisan lines in the interest of modernising and harmonising some parts of the

constitutional text. Given that, as the *Unione* seems currently unable to decide on how to proceed in this respect, it is unlikely that the issue will remain on the table, other than through rhetorical appeals. If, however, such a process was initiated, Prodi would strive to have at least the support of one, if not two, centre-right parties, and could even offer significant bargaining chips to Bossi concerning reform of the institutional framework. On their side, both the Northern League as well as the *Udc* are split between pragmatism—and hence openness to Prodi—and old loyalties towards Berlusconi, who despite numerous setbacks, has had no real challenger from within the coalition since the electoral defeat.

This mirrors a political climate dominated by the opposition's intransigence and resolve in failing to provide any kind of backing to the current government, even at the price of losing credibility insofar as continuity is concerned, as with foreign policy, for example. The logic behind that is the hope that the numerical weakness of the centre-left's majority in the upper house—only two senators, not counting the seven life-nominated ones—will soon bring about the collapse of the government. Berlusconi's overt attempts to exacerbate any tension within the opposing camp has proved until now to be counter-productive. On party-identity matters—such as the war in Iraq and the future of the Afghanistan mission—despite the emergence of ontological differences between left-moderate and extreme leftist parties, the “anti-Berlusconi glue” and the will to deliver reforms are facilitating the open expression of dissent within clearly defined boundaries. In other words, notwithstanding Prodi's weak status due to his inability to count on a party for support, the *DS*' (Left Democrats) unconvincing performance at the general elections, and the Senate's delicate equilibrium, a sense of shared commitment and responsibility seems to prevail among all centre-left parties. The more than 200-page electoral program

remains the blueprint for any undertaken policy suggestion.

### **Economy: Welfare Reform, Public Debt Reduction, and Alleviating Labour Costs through a Heterogeneous Coalition**

The two most pressing dossiers are welfare reform and the reduction of public debt. On the first front, a reform of the pension system represents the most politically costly but urgent issue which needs to be faced. Italy has the most expensive retirement system in the whole EU, and the worst poverty-combating policy of the European Union. However, despite the authoritativeness of the Chancellor of the Exchequer and former ECB governor, Tommaso Padoa-Schioppa, any step in this direction will have to wait until autumn and will be the object of long negotiations with the trade unions.

The second front, politically less “hot”, will consist of the adoption of a series of long-awaited measures pushing for the liberalisation of the energy market, of public local services, and of state-supported industries, such as Alitalia. The Minister for Industry, Pierluigi Bersani, in charge of these dossiers, has already come out with concrete—and quick to implement—policy proposals aimed at liberalising the services' market.

In an attempt to foster competition, these measures were greeted as a “revolution” by most Italian newspapers. This proved to be the first strong symbolic gesture by the government. Italy traditionally suffers from strong corporatist professional organisations, comprising a never-ending variety of categories, ranging from lawyers, cab drivers, architects, and journalists who act as strict gate-keepers to these professions. As a consequence, not only is the job market extremely restricted—for foreigners as well as for Italian nationals—but the same organisations impose their prices with no higher authority checking on them. Some of the privileges

enjoyed by the members of these lobbies will be curtailed, thereby increasing consumers' power. Protests are already on the rise, however, as these vested interests have never before been attacked so directly and resolutely, neither by the left wing nor by Berlusconi's government.

This measure is zero-cost for the government and will not, in the short-term, provide any additional source of revenue for the state. It signals, however, the will to proceed in the too-long awaited road to modernisation, even at the cost of putting up constant fights against powerful and well-rooted interest groups.

As far as public spending is concerned, the new Dpef (Multi Year Fiscal Plan) has discontented critics for the timid cures it puts forward.

Spending dramatically increased under Berlusconi's tenure, with the country having been labelled the "sick man of Europe" and with two of the three main international rating agencies having threatened to downgrade its credit ratings by year-end. The budget deficit is above 4% of GDP, the public debt/GDP ratio rose in 2005 for the first time in a decade (reaching 106% of annual GDP) while Italy's market share in world trade has fallen from 4.6% in 1995 to 2.7% in 2005.

On top of that, youth unemployment—which accounts for 23.6% of the overall work force—as well as the precariousness of jobs, especially for young people, is on the rise and, catalysed by the French protests, it is gaining increased media attention.

The government will start by reducing labour costs by 5%. The cost of this policy should reach nine million euros, and it will be financed through a mixture of measures. First of all, Prodi and Padoa-Schioppa will introduce a reform of the taxation of bank accounts—they will be standardised at 20%, while in France it reaches 27% and in Germany 32%. Then new ways of giving financial incentives to medium and small enterprises should be remodelled, public spending will be cut—the example, paradigmatic in its out-of-control proportions,

are private consultancies to state apparatuses—and finally, the usual call for a tougher stance against fiscal evasion. This policy will benefit both enterprises and workers (by two-thirds and one-third respectively). The government hopes that it will, at least to some extent, relieve small and medium enterprises from excessive labour-cost burdens, thereby facilitating the recovery of market competitiveness. The advantages in workers' wages will be less significant, but may still give a boost to stagnating consumption.

The centre-left political economy programme is far from ambitious; first of all, it aims at restoring what was achieved by Prodi during the 1996 legislature. And yet, doubts remain as to whether the coalition parties will stick to the programme or start bargaining over each single policy proposal.

After the appointment of Fausto Bertinotti, leader of Communist Refoundation, as President of the lower house of Parliament, one could expect from his party—traditionally hostile to economic reforms—an increased sense of responsibility in respecting the electoral pact, also given his institutional visibility and hence increased accountability.

In the case of economic reform, despite the consensus reached on paper, the scarce reference to trade-offs designed to relaunch the economy suggest that the real compromises have yet to be made. This will be by no means a straight-forward game, with a centre-right opposition determined to sink the government at the first opportunity and call new elections, claiming that the coalition's composite nature is a natural obstacle to the government's stability.

But another scenario is also possible, though it would run counter to historical precedents (in 1998, Refoundation Communist caused the collapse of the left-wing government due to divergences over economic choices). The tiny majority in the Senate could oblige the parties to respect a strong voting discipline, with the costs of every defection or last-minute change of opinion being made clear not only to the

parties but also to the electorate. After the full mandate served by Berlusconi, and the *Primarie* won by Romano Prodi, the left-leaning electorate would not understand, let alone forgive, a display of egoistic party interests detrimental to the government's survival. An increased sense of responsibility of every deputy and senator, hence, together with constantly being put under the spotlight, could represent the permissive cause for the consolidation of the cohesiveness that the electorate of the left has long been asking for.

Backing this second hypothesis is the forthcoming foundation of a "Democratic Party" that should encompass the current left-wing coalition's parties. Talk of such a party was limited to small groups of leftist intellectuals but has now become part of the mainstream political discourse. It now appears certain that such a party is needed—and not only to cement Prodi's leadership as he doesn't have a party of his own. What remains to be seen is how the internal equilibria among the different political entities will be successfully harmonized. The challenges are several: the two main components—the Left Democrats (DS) and the Margherita, the leftist Catholic group—present significant divergences, which hardly look reconcilable within the same party, especially on social and religious issues. It is even harder to imagine if and how the remaining parties will give up their idiosyncrasies and trademark features, without risking the loss of their visibility and voice.

### **A 180° Detour in Foreign Policy from the Berlusconi Era?**

In the centre-left manifesto, two chapters are dedicated to foreign policy: international politics and Italian European policy. It is the second that receives the most attention.

In general, one can assume that the coalition will work in a much more subtle and pragmatic way to foster, on the one hand, the Italian role in world affairs and, on the

other, a new impulse to the stagnating European integration process.

During his first visit to the United States, Massimo D'Alema, the new Foreign Affairs Minister, did his best to give the impression that transatlantic relations will carry on, to a significant degree, in a spirit of continuity with respect to the previous idyllic Rome-Washington relationship. He made it clear, however, that Italy will act in a coordinated way with the rest of the EU.

D'Alema had little to offer Secretary of State Condoleezza Rice: as agreed in the electoral campaign with the other parties, the withdrawal from Iraq, despite its not being implemented immediately, will take place quickly, and only civilian personnel will remain in the field. Italy will follow the more gradual approach embraced by the Netherlands rather than the one followed by Madrid. The withdrawal is partially motivated by financial reasons and will start in the autumn. In a new departure from what had been previously declared—namely that thirty to forty technicians would remain in Nassiyria—Rome denies it will leave *any* contingent on the ground. According to a "Cooperation Pact" agreed with Baghdad, Iraqi military and police forces will receive training in Italy, and Rome will support the infrastructure building effort comprising schools, hospitals, and other civilian buildings.

The new Foreign Minister also reiterated the EU position advocating the closure of Guantanamo, an issue which Berlusconi had previously skilfully avoided.

The attempt to capitalise on Berlusconi's positioning of the country as a close US ally—pushing, for example, for a multilateral UN-backed approach towards Iran—is already showing its limits. Rome has lost some of its previous appeal in Washington as a staunch US ally, and is now heading towards a pragmatic working relationship.

As the recent dispute over the continuation of the peace-keeping mission in Afghanistan points out, domestic convergences on foreign policy issues should not be taken for granted.

In June, eight senators from two communist parties and the Green party, voiced their objections to the decree refinancing the ISAF mission in Afghanistan, where 1,350 Italian soldiers are stationed. Their request for an “exit strategy” from Afghanistan provides fertile ground for enhancing domestic opposition as well as European apprehension concerning the capacity of the new government to deliver. What should be stressed, however, is that none of the small parties could survive the fall of the government. As one of these leaders wisely acknowledged, there are too many reforms still to be undertaken for which it is necessary to keep the legislature afloat.

These turbulences, despite slowing down the pace of policy initiatives and creating misunderstandings abroad, hence, should be accorded a limited relevance. They merely signal that stakes, in other domains, are getting higher, and that Mr. Prodi will have to compensate for these political forces more than he forecasted.

More pragmatism will also characterise the evolution of the relationship with Moscow. One of Mr. Prodi’s first visits abroad was to Russia, where new bilateral agreements on energy supply were signed. As long as the EU does not embark on an exhaustive and common energy strategy, Italian politics towards Russia will be characterised by geo-strategic concerns, with human rights controversies remaining in the background.

Italy’s European policy has been under the spotlight less as Prodi’s credentials and preferences in this domain are hardly questionable. He will namely be in charge of the country’s European policy himself, in a functional division of labour with the Foreign Affairs Minister, who will be especially attentive to the delicate relationship with Washington.

As far as the constitutional debate goes, Prodi will support the Commission’s Plan D for democracy, dialogue, and debate, aimed at widening the national debate and promoting citizens’ participation. In this respect, Rome has manifestly singled out

Berlin as a natural partner for any European initiative. Despite the lack of details, the mantra repeated by foreign policy advisors is that the government will champion groundbreaking proposals. According to Prodi, the EU constitutional treaty is and will remain on the agenda at least until 2007. If by then no agreement is in sight, a shorter and simpler version of the treaty should be drafted.

Italy has traditionally strongly supported the politics of enlargement towards the Balkans, first initiated by the same Prodi and carried on as of late by the centre-right-appointed commissioner Frattini in a climate of ideological and political continuity. With Croatia having started negotiations, Macedonia enjoying the candidate status, and the ongoing Stabilisation and Association Agreements with Bosnia, Serbia, and Albania, Italy will closely monitor and support each of these processes.

These broad orientations will find no opposition from within the coalition and will actually be forcefully backed. Where one could forecast more disagreements looming on the not so distant horizon is Middle Eastern politics. The reactions from some leftist dovish members of the communist party to suicide bombings in Tel Aviv—expressing sympathy for the Palestinian cause—hinted at potential future friction within the coalition. The positions expressed reflect a past attitude in Italian politics of quite unambiguously aligning with the Palestinians. Can a realignment in this direction be expected after five years of decisively pro-Israeli politics? It is too early to say, but judging from recent declarations, a pro-Palestinian U-turn is unlikely. Italian foreign policy in this area will be more cautious than in the past, given the actual shape of the PA government under Hamas. The approach espoused by Prodi and D’Alema is the one of the so-called “*equi-vicinanza*” (“equal-proximity”) to both peoples, and it is arousing hostility among the Italian Jewish community.

It is based on the idea that only by consciously avoiding double standards can

there be a chance for the two sides to mutually improve their situation. It also presupposes, however, a more direct Italian involvement in the conflict than under the previous government and it clearly aims at bringing a fresh impetus into the European arena. In the current Israeli-Arab crisis, for example, Prodi and D'Alema have followed the lead of the Finnish Presidency of the EU as well as Kofi Annan in calling for Israeli restraint in its attacks against Lebanon. At the same time, however, Prodi has tried to act as a facilitator between Israeli PM Ehud Olmert and Lebanese PM Fouad Siniora.

Italy will call on the EU to adopt a bolder stance within the Quartet towards the Israeli-Palestinian situation. In this respect, D'Alema's historical sympathy for the Palestinian cause may become a catalyst to gather momentum for a peace-keeping initiative, leaving aside, at least for the time being, any peace-building idea.

Despite being the first commercial partner of Teheran, Italy has had no consistent foreign policy towards Iran, which is also due to Berlusconi's allegiance to the White House's strategic priorities. Now, in the absence of an elaborate vision of political preferences in the area, Rome will try hard to be included in the EU-3. To enter the game, Italy will offer economic carrots as well as political recognition, as it is not in the position to grant any significant military deterrent capacity.

What seems clear to politicians in Rome is that in order to recover some of the international legitimacy and credibility lost in the last five years, it will not be enough to avoid unilateral policies or act under the EU umbrella. Prodi and D'Alema will have to forge a new diplomatic effort to tackle the most pressing challenges, from Teheran to Jerusalem, to the rapidly evolving situation in the Balkans. They, however, will only be able to do that if the necessary economic reforms are undertaken. Only then, maybe, will they be in the position to claim the need to strengthen and enlarge the G8, the only remaining forum where Rome can still enjoy a lead role.

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