THE LONDON SCHOOL OF ECONOMICS AND POLITICAL SCIENCE

Essays on the Political Economy of Economic Adjustment: Austerity, Labour Market Reforms, and Inequality.

by

Fabian Mushövel

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Declaration

I certify that the thesis I have presented for examination for the PhD degree of the London School of Economics and Political Science is solely my own work other than where I have clearly indicated that it is the work of others (in which case the extent of any work carried out jointly by me and any other person is clearly identified in it).

Statement of conjoint work:

This thesis is solely my own work. I declare that my thesis consists of 80,010 words.

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Abstract

The sovereign debt crises in European Union member states after the year 2010 saw a number of comprehensive bailout packages of unprecedented size. The various fiscal and structural reforms on which the bailouts were conditional substantially shaped welfare states and labour markets in the affected countries. Discussions about the reform programmes in the political economy literature mostly revolve around their effects on economic growth and fiscal sustainability. Much less has been written about the distributive effects of these reforms. This thesis puts the question of how the burden of the adjustment process was distributed among different groups at the centre of the analysis.

Specifically, the thesis focuses on the economic adjustment programmes in Greece and Portugal and analyses their distributive effects, both with regard to the fiscal consolidation measures and the labour market reforms that went along with the austerity programmes. The PhD's central claim is that the distributional consequences of these programmes were crucially determined by how much control over the reform process was exercised by the Troika of IMF, the European Commission, and the ECB, as their preferences and policy objectives differ substantially from those of elected domestic policymakers. Throughout the PhD it is shown, through a mix of descriptive statistics and microsimulation methods (EUROMOD), that the distributive effects – of both fiscal and labour market reforms – vary across and within countries as the degree of Troika control shifts. While the impact of the Troika seems to be progressive with regard to fiscal reforms, the case is more ambiguous for labour market reforms. The tighter the control exercised by the Troika, the more redistributive towards lower income groups became fiscal reforms; labour market reforms, on the other hand, focused largely on breaking up insider privileges when the degree of Troika control was high, but paid little attention to the potential compensation of more vulnerable groups of workers. This is in line with the policy preferences of the Troika institutions, which have adopted a more critical view of excessive levels of income inequality. Importantly, this appreciation of excessive inequality as an important issue for the Troika institutions stems mainly from the fact that it constitutes an obstacle for achieving other policy objectives, such as sustainable economic growth or ensuring a minimum degree of political stability in order to successfully complete the reform process. The Troika paradigm seems more agnostic towards the distributive effects of labour market reforms, which still follow the

economic orthodoxy built on the principle of labour market flexibilization. Overall, the actions of unelected technocratic policy makers seem to be governed by radically different rules based on ideas while elected policy makers seem to be governed by their interest to be re-elected.

The thesis is divided into three stand-alone papers. The contribution of the first paper is to establish the distributive effects of the EAPs, measured with microsimulations, and the preferences of the Troika policy makers. The second paper decomposes the distributive effects of fiscal reforms and identifies the shifting degree of control exercised by the Troika as the key variable determining the reform design and effects. The third paper analyses the consequences of labour market reforms in the context of labour market dualisation. The thesis concludes by situating the findings in the current debates in political science and comparative political economy. It proposes to bridge the gap between the burgeoning electoral turn literature and the new institutionalist literature by re-focusing on the role of actors and ideas in institutional contexts in what the thesis calls ‘situated agency’.

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Introduction

“We all know what to do, we just don't know how to get re-elected after we've done it”

— Jean-Claude Juncker[1]

(then Prime Minister of Luxembourg and President of the Eurogroup)

A.1 Setting the Scene

The global financial crisis of 2008 sent shock waves through the world economy, ultimately resulting in the deepest recession since the Great Depression. Around the globe, governments launched fiscal stimulus programmes on an unprecedented scale in an endeavour to bring back economic growth and shelter their electorates from mass unemployment. As a consequence, public debt levels skyrocketed. In the European Union, and particularly the Eurozone, policy makers reacted to this new challenge by reining in public spending and reducing budget deficits, ultimately contributing to a double dip recession unique to these countries. The imposition of such pro-cyclical fiscal consolidation measures in the midst of a recession was a function of the strict rules of the Stability and Growth Pact, and the lack of control over the common currency at the national level, both of which placed additional restrictions on domestic governments’ spending decisions. This was exacerbated further by deeply political considerations leading to the refusal of Eurozone creditor countries to expand their fiscal activity and bolster domestic demand while simultaneously insisting on austerity in the Eurozone periphery.

[1] Retrieved from The Economist. 2007. “The Quest for Prosperity,” 2007. https://www.economist.com/special-report/2007/03/17/the-quest-for-prosperity.

The advent of the European Sovereign Debt Crisis finally came with the announcement of the newly elected Greek PASOK government in October 2009 declaring that data on the state of Greek public finances had for years been misreported. Rather than the projection of 3.7 per cent of GDP reported by the previous government, the Greek budget deficit in 2009 was expected to be in excess of a record 12.5 per cent of GDP (a figure that would later be corrected upwards twice and ultimately estimated at 15.4 per cent of GDP). Subsequently, Greece's credit rating was downgraded repeatedly causing bond spreads to soar. Efforts of the Greek government to consolidate public finances ultimately proved futile and by April 2010 Greek Prime Minister Papandreou formally requested an international bailout. The European Commission, as an agent of the EMU member states that provided bilateral loans to the Greek government, together with the International Monetary Fund (IMF), and, in an advisory role, the European Central Bank (ECB) formed the so-called Troika, administering an initial €110 billion bailout programme. In return for the financial assistance, the Greek government agreed to a comprehensive Economic Adjustment Programme (EAP) aimed at the consolidation of the public budget through deep austerity measures and the implementation of far-reaching structural reforms.

Contagion effects from the Greek crisis and sudden mistrust in the solvency of other Eurozone periphery countries ultimately caused a number of countries – even with healthy public finances going into the crisis – to follow Greece in being forced to request financial assistance from their international partners. Aside from Spain, which received a financial sector adjustment programme, Portugal and Ireland agreed to comprehensive Troika-administered EAPs in 2011 followed by Cyprus in 2013.

Almost a decade after the onset of the sovereign debt crisis in the Eurozone, the majority of academic research, particularly in the economics discipline, has focused on assessing the success of the reform programmes with regard to restoring public finances and achieving growth-enhancing structural reforms. Less attention has so far been paid to the question how a prolonged period of severe austerity measures, with deep cuts in public and social expenditure, as well as substantial transformations of domestic labour markets after years of flexibilising reforms, have affected inequality within the EAP-recipient countries. This constitutes a significant gap in the literature given the sheer scope of the EAPs and their potential to radically alter the programme recipient countries' welfare states. Therefore, this thesis puts the distributive consequences of the various reforms centre stage and provides a novel comprehensive account of how the burden of the adjustment stemming from tax hikes, benefit reductions, and deregulation of labour markets was distributed among different social groups.

More specifically, the thesis first asks how the fiscal reforms in the EAP-recipient countries, particularly with regard to taxes and benefits, affected income inequality. Secondly, the thesis asks how changes in labour market legislation affected different labour market groups, specifically in the context of the highly dualised labour markets of Southern Europe. At the centre of the analysis are furthermore the questions of how welfare states have changed throughout the adjustment process more generally, and how the involvement of the unelected technocrats of the Troika influenced the distributive effects of these reforms. The latter question is of particular salience given that unelected policy makers are not directly bound by any potential responsiveness to certain voter groups or, for that matter, the electorate as a whole. The distributive effects of Troika-prescribed reform measures are thus more difficult to predict given the fact that much of the political science literature on inequality and redistribution revolves around the notion of government responsiveness to voters or particular voter groups. At the same time, it was unclear at the onset of the adjustment process how strongly the Troika would control the reform process and how much discretion would be left to the domestic governments in designing the exact reform measures. In other words, how much ownership did the Troika institutions take of the reforms and how much did the reforms ultimately reflect the preferences of the three Troika bodies? In this context, the thesis engages with the theoretical question of how institutions change in the particular context of international organisations by the example of the three Troika bodies.

The second part of this introduction provides a review of the existing literature on (1) the origins of the Eurozone crisis and how austerity emerged as the dominant policy response, (2) the interplay of austerity and inequality, framing the former as an instance of distributional conflict, (3) the issue of inequality more generally, including different approaches explaining why and how policy makers redistribute incomes, how these dynamics played out specifically in the case of the Eurozone, and how inequality beyond disparities in income is manifested in the labour market, and (4) finally, what can be expected from the involvement of the technocratic policy makers of the Troika with regard to the distributive effects of the EAPs. The third part of the introduction outlines the research design of the thesis including (1) a justification for the case study selection, showing data on the comparability of the selected cases along a number of relevant variables, and (2) a presentation of different measurements and data used throughout this thesis. The fourth part of the introduction provides an outline of the thesis' synopsis and its contributions to the relevant literature.

A.2 Literature Review

A.2.1 The Eurozone crisis and austerity

When the Global Financial Crisis (GFC) unfolded and gradually turned into a full-blown global economic crisis, governments around the world uniformly reacted with a revival of Keynesian policies characterised by large-scale deficit spending, fiscal stimulus programmes, and bailouts of private sector firms on an unprecedented scale. In the first place this pertained to the financial sector with prominent examples including multi-billion bailouts for Bank of America and Citigroup in the United States, Royal Bank of Scotland in the United Kingdom or Commerzbank in Germany. When the crisis spread to the real economy, governments likewise stepped in and provided large financial assistance packages to private firms either directly through subsidised loans and credit guarantees or indirectly through various demand-stimulating policies such as scrapping premia for the automobile industry. Moreover, a combination of tax cuts and cuts in social security contributions, additional benefit payments to households, and investments in infrastructure programmes aimed at further stimulating domestic demand was implemented with varying sizes and policy mixes across the advanced capitalist democracies.

These measures proved largely successful in gradually containing the crisis and economic growth returned by 2010. At this point governments of EU and particularly Eurozone member states departed in rather spectacular fashion from the initial Keynesian response to the crisis and instead turned to severe austerity measures paired with far-reaching structural reforms.

A.2.1.1 Austerity as the dominant policy response

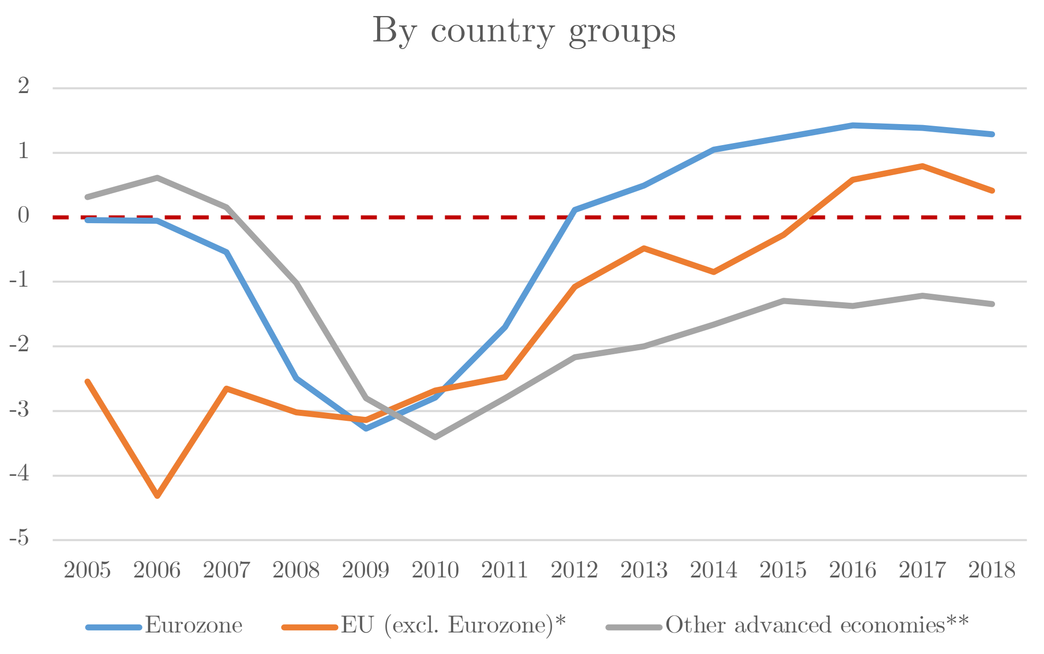
This turn away from expansionary fiscal policy towards austerity in such an abrupt way requires additional explanation for a number of reasons, which will be outlined in the following. First, however, it is necessary to identify cases of austerity comparing EMU member states and other advanced capitalist democracies before the political and economic factors that motivated this particular policy choice and foreclosed alternative policy options in the particular context of the Eurozone crisis can be explained.

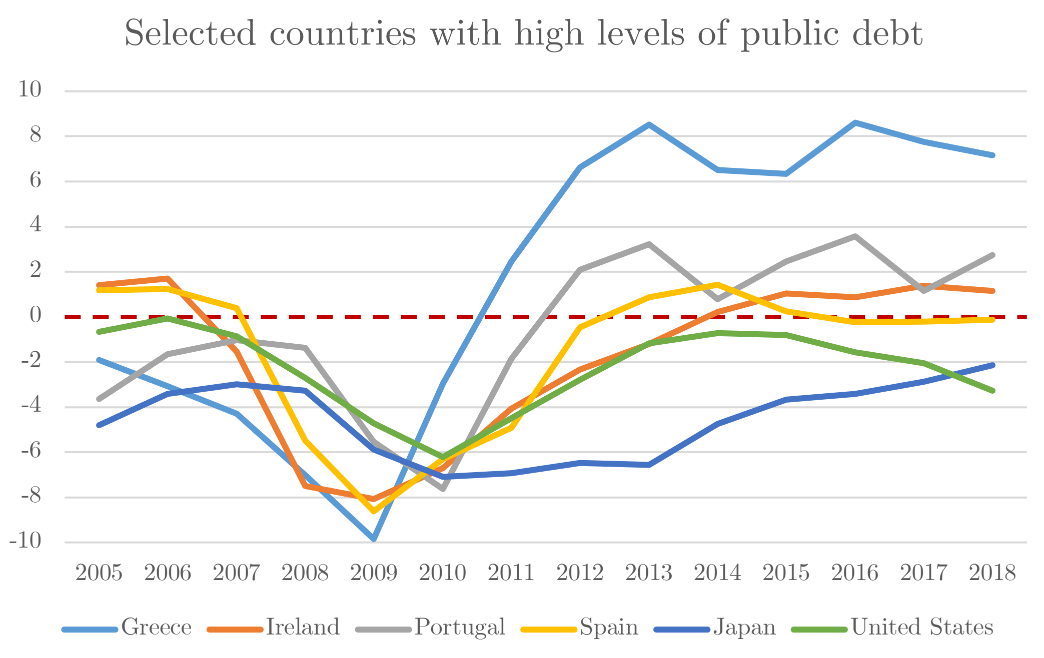
Austerity refers to a set of policies aimed at consolidating government budgets by cutting expenditure or raising taxes, in practice usually combining the two. Measuring austerity, however, needs to go beyond simply observing changes in governments' balance sheets due to the two-way interaction between fiscal policy and economic growth. In other words, government spending invariably moves with changes in GDP growth given the importance of automatic stabilisers. For instance, government expenditure increases during times of high unemployment due to increased spending on unemployment benefits and falls in times of high employment even without specific government intervention such as changes in tax or benefit policies. To address this measurement problem, phases of austerity can be identified in two ways: (1) In order to exclude changes in government spending induced by automatic stabilisers, austerity can be measured as substantial reductions in the cyclically adjusted primary budget balance; (2) more recently, scholars have turned to what has been dubbed the "narrative approach", i.e. identifying austerity policies by analysing the published motivations of policy makers for each legislative change concerning tax and benefit policies (Romer and Romer 2010; see also Alesina, Favero, and Giavazzi 2019). Because of higher ease of interpretation and comparability across countries, it is more suitable for the purpose of this work to use the former of the two approaches.

The *cyclically adjusted* budget balance is a measure of government revenues minus expenditures adjusted for the fluctuations of the business cycle; in other words it refers to the government budget balance at full potential of the economy. Furthermore, the cyclically adjusted *primary* budget balance excludes net interest payments. Much of the economic literature analysing austerity policies rely on this measure, typically using a particular threshold of the annual change in the cyclically adjusted primary budget balance to denote phases of fiscal consolidation (Giavazzi and Pagano 1990; McDermott and Wescott 1996). Alesina and Ardagna (2009), for instance, argue that an annual increase of the figure by 1.5 per cent of GDP constitutes a sufficiently sharp and large change in the fiscal stance to be labelled as austerity.

In Figure 1, the cyclically adjusted primary budget balance is mapped, first, for three analytical country groups (the Eurozone, non-Eurozone EU member states, and other advanced countries), and, second, selected countries that had high levels of public debt in the years following the GFC. The data show the following: (1) Eurozone member states implemented particularly harsh austerity measures from 2010 onwards with the average of the bloc as a whole reaching a cyclically adjusted primary budget surplus from 2012 onwards; (2) other EU member states outside of the currency union also implemented austerity measures, particularly from 2011 onwards, although in a less extreme fashion on average running a budget surplus from 2016 onwards; (3) other advanced countries outside of the EU followed a path of softer fiscal consolidation from 2010 onwards but in absolute terms the country group on average never ran a budget surplus thus slowing down but not actually reversing the accumulation of public debt.

Figure 1: Cyclically adjusted primary budget balance per year, as % of GDP





Source: Fiscal Monitor, International Monetary Fund (2020)

*Notes: * EU excludes Bulgaria due to gaps in the data*

*** Other advanced economies are Australia, Canada, Israel, Japan, Republic of Korea, New Zealand, Norway, Switzerland, United States based on the definitions used in the IMF Fiscal Monitor database.*

Table 1: Annual change in cyclically adjustment primary budget balance

		2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Eurozone	Austria	-0.187	-1.457	0.491	0.819	0.652	0.797	-0.577	1.566	-1.046	0.131	0.234
	Belgium	-0.853	-3.006	0.406	-0.493	0.273	1.331	-0.146	-0.014	-0.328	0.894	-0.523
	Cyprus	-2.395	-4.056	-0.226	-0.612	2.272	2.574	3.962	-0.232	-1.472	0.457	0.391
	Estonia	-2.917	5.575	1.275	-0.968	-1.659	0.370	0.662	-0.485	-0.443	-0.822	-0.580
	Finland	-0.766	-1.877	-1.157	0.246	0.006	0.495	0.263	0.993	-0.040	-0.361	-0.204
	France	-0.064	-2.297	-0.232	1.213	0.462	0.804	0.004	-0.039	-0.173	-0.136	-0.065
	Germany	-0.522	0.169	-2.871	2.162	1.283	0.187	0.084	0.217	-0.169	-0.494	0.411
	Greece	-2.730	-2.830	6.887	5.426	4.144	1.904	-2.008	-0.178	2.281	-0.840	-0.606
	Ireland	-5.958	-0.568	1.380	2.627	1.724	1.145	1.421	0.821	-0.166	0.512	-0.237
	Italy	-0.646	-0.667	-0.099	0.557	2.298	0.344	-0.329	-0.359	-0.508	-0.786	-0.098
	Latvia	-5.898	4.012	0.542	1.808	2.880	-1.556	-0.289	0.344	0.607	-0.743	-0.130
	Lithuania	-2.341	1.758	3.674	-3.815	5.433	-0.050	1.602	0.547	0.375	-0.519	-0.258
	Luxembourg	0.163	-0.749	-1.220	0.861	0.987	0.350	-0.153	-0.201	-0.108	-0.375	1.448
	Malta	-2.898	2.786	0.007	0.681	-0.740	1.130	-0.304	-1.067	2.391	2.440	-2.210
	Netherlands	-0.236	-2.529	-0.483	0.502	1.572	1.613	0.529	-0.417	1.525	0.394	-0.478
	Portugal	-0.340	-4.173	-2.074	5.785	3.943	1.118	-2.442	1.683	1.113	-2.412	1.579
	Slovak Republic	-0.697	-1.542	0.142	3.389	0.380	1.785	-0.829	-0.913	0.128	1.231	-0.330
	Slovenia	-2.012	-0.129	0.363	-0.794	4.120	-8.529	8.553	2.472	0.135	0.612	-0.212
	Spain	-5.846	-3.147	2.326	1.367	4.460	1.323	0.569	-1.173	-0.483	0.010	0.099
EU excl. Eurozone	Croatia	-5.542	2.795	1.778	0.128	0.341	-1.542	3.064	-0.168	1.225	2.460	1.592
	Czech Republic	-0.713	0.651	-1.126	0.090	1.323	1.152	-0.056	3.397	-1.351	0.258	1.279
	Hungary	-2.719	4.993	1.407	3.108	0.016	-1.118	4.606	-0.312	-1.661	-0.154	-0.164
	Poland	-1.162	1.551	-1.224	-2.245	-0.428	1.849	1.854	-0.206	-0.090	0.612	0.168
	Sweden	-0.160	0.562	-1.021	-0.060	-0.858	-0.736	-0.503	-0.055	-0.216	0.069	1.113
	United Kingdom	-0.342	-0.562	-2.036	-1.757	2.379	1.643	-0.562	0.892	-0.098	0.183	1.143
Other advanced countries	Australia	-0.135	-0.376	-2.437	-3.106	-0.358	0.826	1.265	0.829	0.064	0.227	0.240
	Canada	-0.376	-0.169	-1.690	-1.407	-1.743	0.611	0.892	0.644	1.071	0.584	-0.125
	Israel	0.371	-0.250	-2.359	-2.132	1.269	0.277	-1.366	0.061	0.688	1.472	-0.558
	Japan	1.387	0.433	-0.283	-2.603	-1.222	0.168	0.445	-0.092	1.839	1.058	0.272
	Republic of Korea	0.195	-1.215	-0.094	-1.032	0.945	0.145	0.412	-0.783	-0.265	0.258	1.111
	New Zealand	-0.430	-0.819	-1.642	-2.595	-2.674	0.744	2.650	0.725	0.399	0.322	0.406
	Norway	0.247	-0.817	-0.451	-1.069	0.349	0.696	-0.143	-0.436	-1.248	-1.305	-0.934
	Switzerland	0.839	-0.075	0.206	-0.132	-0.488	0.233	-0.132	-0.991	-0.018	0.796	-0.392
	United States	0.605	-0.783	-1.857	-2.019	-1.488	1.713	1.716	1.609	0.462	-0.099	-0.749

Source: Fiscal Monitor, International Monetary Fund (2020)

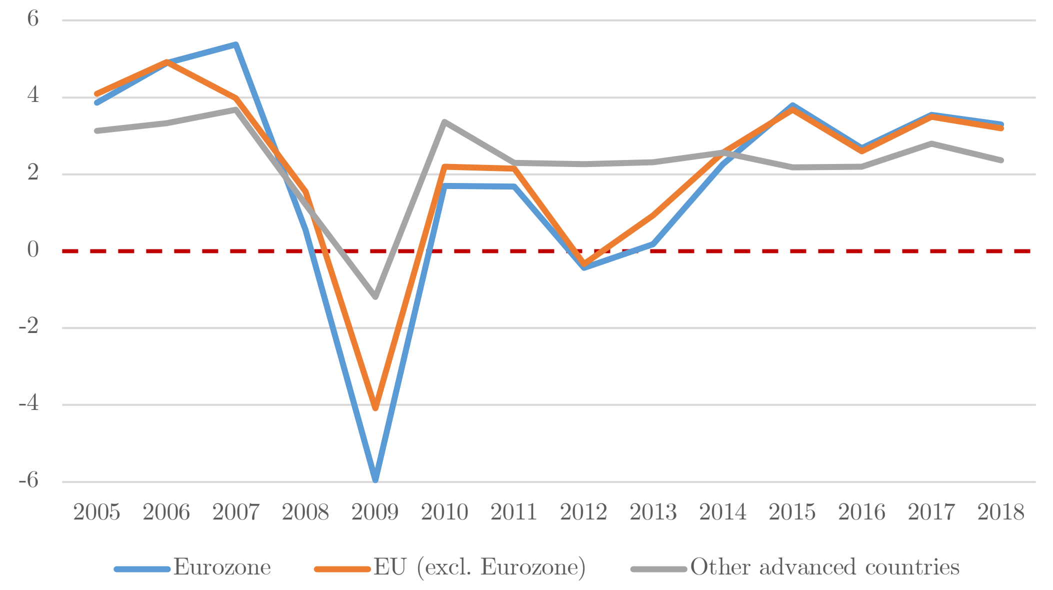
Colour coding refers to annual change in cyclically adjustment primary budget balance of

- *$>$ 1.5% of GDP (red)*
- *$>$ 0.5% of GDP, $\leq$ 1.5% of GDP (yellow)*

Table 1 further illustrates these points by providing country-specific data on the annual change in the cyclically adjusted primary budget balance. Following the Alesina and Ardagna convention, positive changes in this figure of at least 1.5 per cent of GDP are colour-coded in red denoting severe cases of austerity while positive changes of between 0.5 and 1.5 per cent of GDP are colour-coded in yellow denoting softer cases of austerity. The data show that the most severe cases of austerity are to be found in the Eurozone, often over a multiyear period, from 2010 onwards, with the harshest measures in Greece, Portugal, Spain and Cyprus, as well as the Baltics. Non-Eurozone member states of the EU likewise underwent extended periods of austerity, most notably Hungary. Among other advanced countries outside of the EU, only the United States had a multiyear phase of severe austerity, although the sum of the fiscal consolidation effort between 2013 and 2015 did not exceed the fiscal expansion in the preceding three years and in absolute terms the US government did not run a cyclically adjusted primary budget surplus.

Next, juxtaposing these findings with data on real GDP growth in the three analytical country groups reveals the following: While economic growth returned in all three groups by 2010, only the countries outside the EU maintained growing economies in the following years. The European bloc, on the other hand, was drawn into a double dip recession with negative growth rates in 2012 and low growth rates in 2013 (with negative growth rates in eight out of the 19 countries forming the currency union in 2013), a trend that was slightly more pronounced for the Eurozone than the EU member states outside of the currency union (see Figure 2). Of course, assessing the impact of various factors on economic growth is a complex task subject to heated disagreements among economists. However, given the similarity and particularity of on the one hand the European double dip recession, and on the other hand the austerity-centred course of policy reforms charted by EU policy makers during the same time period, it stands to reason that the two are connected.

Figure 2: Average real GDP growth by country groups per year, in % of GDP



Source: Fiscal Monitor, International Monetary Fund (2020)

In fact, analysing growth effects of austerity measures at the country-level in the Eurozone, IMF economists Olivier Blanchard and Daniel Leigh showed prominently that fiscal multipliers had been markedly underestimated in the design of the adjustment policies in the Eurozone and were actually "substantially *above one* early in the crisis" (2013, 120). In other words, any reduction in government spending during that time would result in a loss of economic output greater than the original reduction of government spending. De Grauwe (2013) has put forward a similar argument although focusing on the growth effects of austerity measures in the bloc as a whole rather than at the country level, suggesting that the European double dip recession is a result of an asymmetric imposition of the adjustment burden onto Eurozone debtor countries. In other words, while harsh austerity measures were implemented in the Eurozone periphery, creditor countries, rather than increasing their own spending in order to offset the debtor countries' austerity policies, chose to follow a similar, if somewhat less extreme, course of balancing their budgets.

This asymmetric adjustment characterised by austerity in the periphery without fiscal expansion in the creditor countries created a deflationary spiral ultimately causing the double dip recession.

The data presented in Figure 2 as well as Table 1 highlight two important contradictions in the response of EU and particularly EMU policy makers to the crisis and their heavy focus on austerity: (1) They were rather alone in this particular policy choice when compared with other advanced capitalist democracies, which, despite high levels of public debt in a number of cases, did not follow the European austerity example; (2) the pro-cyclical nature of such policies could have been expected to induce a palpable risk of stifling the fragile economic recovery, which, in fact, ultimately materialised by the year 2012 causing EU and EMU member states to slide back into a recession while other advanced countries continued on their path of economic recovery. This suggests that in economic terms austerity was neither necessary nor beneficial, which raises the important question why it constituted the cornerstone of the policy response to the Eurozone crisis. The following will elaborate on this question in more detail.

In order to understand the particular crisis management in the Eurozone one must understand three factors and their interplay: First, the ideational and institutional foundations of the economic policy consensus that shaped and was shaped by the European integration process; second, the economic and political realities emerging from the unique intricacies of an incomplete Economic and Monetary Union; and third, the politics of the Eurozone crisis revolving around a misdiagnosis of the roots of the crisis and perceptions of moral hazard. In conjunction, these three factors explain not just why the uniform response to the sovereign debt crisis was to implement immediate and severe austerity measures, but also why austerity mostly took the form of government expenditure cuts rather than revenue-increasing measures like tax hikes.

A.2.1.2 The ideational and institutional basis of European austerity

Historically, the European project has followed distinctly market-liberal ideas of economic policy, which, particularly since the run-up to the Maastricht Treaty, were increasingly codified in fixed rules. The ultimate design of the Maastricht Treaty, which formed the basis for the creation of the European Economic and Monetary Union, marked a political success for a group of countries, the most prominent representative of which was Germany, pressing for convergence on fiscal conservatism prior to the formation of or entry to the euro area. This convergence manifested in rather strict criteria including maximum debt, deficit, and inflation levels that national economies would be required to meet in order to be allowed to enter the currency union[2]. These convergence criteria were designed on the insistence of mostly hard currency countries, again, first and foremost Germany, fearing for the stability of the yet to be introduced euro (Dyson and Featherstone 1999). In fact, the design of the convergence criteria were not least the result of especially Germany and the Netherlands pushing, although ultimately unsuccessfully, to keep countries like Italy that were perceived not to follow the path of fiscal conservatism out of the currency union (Buiter 2006).

Ideologically, this insistence on fiscal conservatism is deeply rooted in Ordo-liberalism, the German variant of market liberalism predicated on the notion that the state's prime objective is to establish markets and otherwise ensure their functioning free from intervention and under perfect competition

[2] The convergence criteria are outlined in Article 109j(1) of the Maastricht Treaty and include: (1) high levels of price stability (denoted as being close to the three best-performing member states, i.e. those with the lowest inflation rate); (2) a budget deficit not in excess of three per cent of GDP and a debt-to-GDP ratio of at most 60 per cent of GDP or if above that threshold the ratio shall have "sufficiently diminished and must be approaching the reference value at a satisfactory pace" (as per Article 104c(2) and the Excessive Deficit Protocol); (3) exchange rate stability, prohibiting the devaluation of their currency for at least two years; (4) long-term interest rate stability denoted as average yields on ten year government bonds not in excess of those of the three member states with the highest price stability (*Treaty on European Union* 1992).

(Bonefeld 2012). With a powerful grip on the German political elite, this ideological approach to economic policy making has shaped European integration substantially over the last half century (Howarth and Rommerskirchen 2013). In fact, while initially somewhat hesitant in driving forward European economic and monetary integration, from the creation of the European Monetary System onwards, Germany, at the helm of an 'ordo-liberal coalition' (Dyson and Featherstone 1999, 261), took on a leading role in the realm of monetary cooperation. Importantly, however, this was in recognition of the fact that cooperation provided a lever for pushing for convergence by imposing conditionality mainly in the form of price stability and fiscal restraint (Scharpf 2013), thus enshrining the principles of Ordo-liberalism as rules at the European level.

Overall, the emerging policy consensus was in line with the global shift from Keynesianism to Monetarism (Hall 1993), and an adherence to policies subsumed under the Washington Consensus (Williamson 1990). In fact, the contractual framework of the European Union was so close to these principles in ideological terms that some commentators coined the terms Brussels-Frankfurt Consensus (Sapir et al. 2004) and Brussels-Frankfurt-Washington Consensus (Fitoussi and Saraceno 2004), highlighting the influence of German Ordo-liberalism, Frankfurt being the site of not just the European Central Bank but also the German Bundesbank.

The further dissemination and juridification of market-liberal principles, especially in the post-Maastricht era, was facilitated through the EU's institutional setup: Scharpf (1999) argues that European integration is characterised by a bias towards negative integration, i.e. de-regulation rather than re-regulation. This in turn rests on the inherent impediments of positive integration in a quasi-federal setting, which Scharpf describes as the 'joint-decision-trap' (2006) as well as the institutional asymmetry of the EU, which is stipulated by the notion of "integration through law" (Schmidt 2012). As a consequence, Scharpf argues that EU member states would converge towards an integrated liberal market model (2010; see also Esping-Andersen 1990; Hall and Soskice 2001 for competing interpretations regarding the convergence hypothesis) with little room for fiscal manoeuvre.

For McNamara (1998), the adherence to market-liberal principles materialises first and foremost in the domain of monetary policy. Indeed, the Maastricht Treaty, outlining the principles of the Economic and Monetary Union, saw to the newly created European Central Bank being tasked with ensuring price stability as its prime objective. True to German Ordo-liberalism, and at the behest of the ordo-liberal coalition under German stewardship in an attempt to enforce monetary prudence in a currency union that included countries with soft currencies, the ECB was equipped with unprecedented independence from national governments going even beyond that of the Bundesbank as per Articles 104(1), 105(1), and 107 of the Maastricht Treaty (*Treaty on European Union* 1992).

However, there is no doubt that the emerging consensus in the area of monetary policy, centred around independent central banks and limited interference of governments with markets[3], had a profound effect on fiscal policy. This is because the prioritisation of price stability over other policy objectives such as full employment in turn necessitated the creation of strict fiscal rules so as to not jeopardise the overarching aim of price stability. In fact, building on the convergence criteria of the Maastricht Treaty, fiscal rules were ultimately enshrined in the Stability and Growth Pact, and more recently the Fiscal

[3] Of course, the notion of states intervening in markets is artificial given that markets do not exist in a vacuum and do not have a natural state that they can achieve by being liberated from state intervention. Instead they are always created and regulated by governments, as illustrated by Vogel (2018; see also Block 1994).

Compact stipulating not only that member states would have to adhere to fiscal prudence but also providing for corrective (and punitive) measures if they fail to do so (De Grauwe 2018; Fitoussi and Saraceno 2013). Most importantly, member states thereby agreed to adhere to a maximum level of public debt at 60 per cent of GDP and a budget deficit not in excess of three per cent of GDP. In addition, the reforms of the Fiscal Compact stipulate that governments balance their budgets over the business cycle regardless of absolute debt levels[4] (European Union 2012). Government expenditure and the room for fiscal manoeuvre was thus limited for EMU member states already before the onset of the Eurozone crisis and even more so after fiscal rules were tightened in reaction to it.

A.2.1.3 Design flaws of EMU foreclosing other policy avenues

While the policy consensus that was built around the prioritisation of price stability and adherence to strict fiscal rules lays the ideational and institutional groundwork for general fiscal restraint, it fails to explain the timing of the deep austerity measures implemented in the Eurozone crisis. In other words, why did policy-makers choose to implement such measures in an already struggling economy despite the fact that this could reasonably be expected to further stifle economic growth? In this regard, it is necessary to understand the unique intricacies stemming from the incomplete design of the Economic and Monetary Union.

Ordinarily, when faced with an economic shock inducing a liquidity or even solvency crisis, there are broadly speaking the following strategies amongst which policy-makers can choose in order to achieve the necessary adjustment,

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[4] The Fiscal Compact specifies that a 'balanced budget' is achieved when a country's structural deficit, i.e. its general deficit minus the impact of the economic cycle on government spending and revenue, is at 0.5% of GDP or lower.

provided that default is not an option[5]: (1) stimulating demand through expansionary fiscal or monetary policy, (2) currency devaluation, and (3) austerity through increasing government revenues or cutting public expenditure (Matthijs 2016). However, as outlined above, room for fiscal manoeuvre is extremely limited for EMU member states under the restrictions of the Stability and Growth Pact and Fiscal Compact, foreclosing the possibility for substantive demand stimuli through expansionary fiscal policy sustained over a longer period of time. Moreover, since governments of EMU member states have no direct control over the common currency or the ECB, both currency devaluation and unilateral expansionary monetary policy are impossible.

In addition, the pre-OMT[6] Eurozone lacked a lender of last resort central bank the importance of which during a crisis cannot be overstated. The reason for the crucial role of this policy instrument is that it constitutes an implicit guarantee of liquidity for governments. In other words, as long as governments have control over their own currency and by extension its central bank they can force the latter to provide liquidity in times of crisis in order to be able to roll over their debt when bonds reach maturity and thus avoid solvency problems. With the creation of the common currency governments relinquished this power to the ECB, which in turn is prohibited specifically by the Maastricht Treaty from financing governments. This becomes problematic for a member state of a currency union when during a recession financial markets lose confidence in a government's ability to pay back bondholders in the

[5] For the sake of the argument it is assumed that a default of one country was not a realistic option for policy-makers in the Eurozone crisis due to the risks of contagion effects in the common currency area.

[6] OMT (Outright Monetary Transactions) refers to a programme set up by the ECB following Mario Draghi's 2012 announcement that the ECB would do "whatever it takes" to preserve the common currency. Under the programme, which notably was never used, the ECB would, under certain conditions, buy government bonds in the secondary market thus effectively being able to act as a lender of last resort.

absence of a central bank that is able to step in and provide the necessary liquidity. Markets would react to this by selling bonds and asking higher risk premia of governments thus pushing up bond interest rates, which would further complicate a government's efforts to refinance itself[7]. In the specific case of the Eurozone, this effect was exacerbated further as investors who sold bonds of countries they perceived as risky reinvested them in bonds of countries elsewhere in the Eurozone that were perceived as safe, which limits the access to liquidity for the former countries even more (De Grauwe 2013).

Ultimately, this forces governments to instantaneously impose expenditure cuts in order to be able to service their debt and pay for the higher interest rates. On the one hand, this shows that for countries of a currency union designed in the way the Eurozone was, i.e. without a lender of last resort central bank, policy responses aside from austerity measures are effectively foreclosed. On the other hand, however, this also illustrates that a negative spiral is set in motion: A fast way for governments to cut expenditures is to switch off automatic stabilisers. However, by curtailing this important instrument to cushion the effects of economic downturns a recession can quickly deepen and thus further dry up governments' tax revenues in the face of lower economic activity – which in turn would necessitate further austerity. This bad equilibrium gives rise to the threat that even member states with healthy public finances may ultimately face a solvency crisis as a result of what was initially a simple liquidity shortfall, which is precisely what happened to Portugal,

[7] Note that the described scenario does not necessarily require a central bank to actually step in. Rather, the mere existence of a lender of last resort would likely calm markets sufficiently to prevent the outflow of liquidity and rise of bond spreads. This is why then-ECB president Mario Draghi's 'whatever it takes' speech was so effective in calming the markets even prior to any real action.

Ireland, Cyprus, and to some extent also Spain[8] during the Eurozone crisis (De Grauwe 2013; De Grauwe and Ji 2015).

A.2.1.4 The politics of European austerity

The previous two sections have shown that the ideational and institutional foundations of the EU and particularly the Eurozone formed the basis for an economic policy consensus centred around fiscal restraint. Building on that, the design flaws of the Economic and Monetary Union explain why, despite the likely negative economic effects, immediate and severe austerity formed the bedrock of the crisis response in the Eurozone periphery. Lastly, in order to fully grasp the depth of the austerity measures implemented in and, in fact, imposed on the countries of the Eurozone periphery, the following outlines the politics of the Eurozone crisis that underpinned the austerity-heavy crisis response.

In other words, while it has been established that austerity was effectively the only feasible adjustment strategy under the specific institutional and ideational limitations of EMU membership, countries in the core of the Eurozone, or creditor countries, could have softened the blow for their partners in the periphery, or debtor countries, by increasing their own spending. Particularly, countries with high current account surpluses, most notably Germany, could have used expansionary fiscal policy to stimulate demand within the bloc. This would have offset the internal devaluation policies in the debtor countries through internal revaluation in the creditor countries. Not only would this likely have led to a lower loss of output but, considering the particularities of the design flaws of the Eurozone, it would have also lessened the severity of

[8] De Grauwe (2011) argues that Greece was different from these countries as it was insolvent even before the crisis unfolded and its government avoided default only by hiding the true extent of its budget deficit and public debt level through fraudulent accounting.

the austerity measures imposed on the Eurozone periphery. However, as illustrated in section A.2.1.1 and Table 1, Eurozone creditor countries chose not to implement this strategy. Instead, by following their own course of fiscal consolidation while pressuring the countries of the periphery into deeper austerity, they put the bulk of the adjustment (i.e. austerity) burden onto Southern Europe and Ireland.

The explanation for this policy choice is rooted in a fundamental misdiagnosis of the origins of the Eurozone crisis, particularly in the Northern member states and, most importantly, Germany, as a crisis of competitiveness. Following this narrative, for the German political elite the crisis was rooted in the profligacy of governments[9], and predominantly those in Southern Europe (Blyth 2013; De Grauwe 2013). Similarly, by this logic, the governments of the Eurozone periphery had failed to implement sufficient supply-side structural reforms. Drawing on the German experience of the early 2000s and the economic success that has been ascribed to the structural reforms implemented under the Schröder government in order to overcome economic stagnation, similar policies in true ordo-liberal fashion, along with drastic austerity measures, then erroneously formed the cornerstone of the reforms imposed on the Eurozone periphery despite the rather limited comparability of the two cases (Scharpf 2013, 134f.).

This misdiagnosis of the Eurozone crisis as a competitiveness crisis also explains why German austerity proponents saw no contradiction in the fact that Germany itself, along with France, was the first member state to have broken the deficit rule of the Stability and Growth Pact in 2003 and used its political clout to avoid punitive measures (Howarth 2007), but now pushed for a strict

[9] It is perhaps no coincidence that German is one of the few languages that uses the same word for ‘debt’ and ‘guilt’.

enforcement of the same rules. Having undergone a process of fiscal consolidation itself and even enshrining the so-called 'Schuldenbremse' (debt brake) prohibiting structural deficits in excess of 0.35 per cent of GDP in its constitution in 2009, Germany had become a champion of austerity, which it saw as the basis for its own economic recovery in the early 2000s (see also Mathis and Kutter 2013). The obsession of both German policy makers, particularly but not exclusively among conservatives[10], as well as the public with the 'Schwarze Null' ('black zero', a metaphor for a balanced budget) as *the* guiding principle of German fiscal policy is testament to that. Certainly, this rationale also entailed a strong emphasis on the notion of moral hazard: Conservative politicians in Germany were particularly adamant on obviating any move towards a mutualisation of debt, an idea they viewed as dead on arrival, instead pushing to make an example of countries like Greece in order to deter future fiscal 'sinners' (Dullien and Guérot 2012; Gocaj and Meunier 2013).

Similarly, the misdiagnosis of the Eurozone crisis as a competitiveness crisis exclusive to the Eurozone periphery also explains Germany's and other countries' – such as the Netherlands' – reluctance to acknowledge the problematic nature of their large current account surpluses (Stockhammer 2011). The argument goes: If the periphery countries suffered from a crisis of competitiveness, rather than internal *re*valuation in the surplus countries, which would stimulate demand also in the periphery, the appropriate response would naturally be internal *de*valuation in the deficit countries, which would

[10] While the 'Schwarze Null' is most famously associated with then-finance minister Schäuble of Merkel's conservative CDU, it is important to note that the consensus around balanced budgets that the schwarze Null encapsulates crosses party lines. In fact, when the German Grundgesetz was amended to incorporate the debt brake, only Green and Left Party legislators opposed it in parliament while both Christian Democrats and Social Democrats voted in favour of the amendment.

lead to greater export competitiveness and ultimately economic recovery[11]. The policy response to the Eurozone crisis fashioned by the ideational framework of German Ordo-liberalism also extended to its institutions and in particular the ECB. Woodruff, building on Polanyi, argues that the ECB's crisis response can be described as 'governing by panic' (2016), essentially 'weaponising' market panics by threatening to allow them to go unchallenged in order to push for austerity measures domestically in the debtor countries.

Importantly, the political sway of the ordo-liberal coalition under the stewardship of Germany and the insistence on asymmetric internal adjustment in the Eurozone periphery was not met with opposition from potential natural allies of periphery countries in the Eurozone core such as France. Despite the initially Keynesian response to the crisis, the Sarkozy-Fillon government was rather quick to implement fiscal consolidation measures by 2011 for fear of losing "France's cherished AAA status" (Clift and Ryner 2014, 146). During the presidential campaign, Socialist challenger Hollande had run on a platform criticising the Eurozone crisis management and lack of Keynesian-inspired demand-stimulating policies, and in particular promised to renegotiate the strict fiscal rules of the Fiscal Compact (BBC 2012). After his electoral victory in 2012, however, his government ultimately continued on the path of fiscal consolidation charted by Sarkozy in the year prior. On the one hand, this was supported by powerful French political elites in the Treasury, the Banque de France, and the Budget Ministry pushing for fiscal discipline and 'sound money' policies (Bezes and Le Lidec 2015). On the other hand, the (however accurate) perceived threat of financial markets, traditionally more distrusting of French Socialist governments, pushing up bond yields muted proponents of

[11] Redeker and Walter (2020) argue that aside from the ideational basis Germany's reluctance to balance the adjustment burden through internal revaluation also stems from the fact that distributive conflicts (internal revaluation would have likely been costly for the German export sector) and the clout of interest groups made this strategy politically difficult to pursue.

expansionary fiscal policy (Clift and Ryner 2014). Ultimately, efforts by the Hollande government to reorient French economic policy towards Keynesian-style demand-side policies also foundered on domestic and internal party opposition (Clift 2014), thus making way for the austerity-heavy response inspired by German Ordo-liberalism.

Combining the above-outlined ideational, institutional, and political constraints attached to EMU membership in the particular context of the Eurozone crisis, it is clear that despite the likely negative economic effects, fiscal consolidation would not just be the only adjustment strategy available for policy makers in the Eurozone periphery, but that member states in the core of the Eurozone, most prominently Germany, would use their clout to impose deeper austerity on their Southern European and Irish partners. At this point it is important to note, however, that austerity per se can take on different forms in terms of combining expenditure cuts and tax increases. On the basis of the above-outlined policy consensus based on ordo-liberal economic ideas that the European integration project has so far followed, it is clear that expenditure cuts would take priority over tax increases given the limited role assigned to the state in Washington-Consensus-style economic orthodoxy (Stiglitz 2008).

A.2.2 Austerity and the politics of inequality

The previous section established that the EU and in particular the Eurozone (1) was relatively alone in their pursuit of harsh and wide-spread austerity measures in the aftermath of the GFC and especially in the sovereign debt crisis compared with non-European countries; (2) bore the negative consequences of pro-cyclical fiscal consolidation in the midst of (or shortly after in some cases) an economic downturn exemplified by the double dip recession of 2012-13, but (3) due to institutional, ideational, and political reasons pressed ahead with this set of policies regardless.

The thesis shows in detail in the second paper that phases of austerity are ultimately to be considered as instances of distributional conflict, given the fact that government expenditure cuts and tax increases invariably produce winners and losers. This means that in order to explain the distributional impact of austerity measures, it is necessary to understand what drives the distributional conflict triggered by austerity pressures and how policy makers typically solve such conflicts.

In a narrow sense, this is done by outlining the extant literature on the politics of inequality and redistribution. In this vein, a particular focus is put on the welfare state as the key factor in mitigating inequalities produced by market mechanisms in advanced capitalist democracies, which are all characterised by the existence of mature welfare states with large although varying redistributive capacities. In this regard, the section outlines several political science theories seeking to explain different levels of inequality and redistribution, their institutional roots, and political determinants within different welfare state settings. Additionally, in a wider sense, it cannot be ignored that any profound analysis of the distributional impact of policy reforms ultimately also relate to the notion of institutional change, which will be explored further throughout the three papers of this thesis.

Inequality has become a prominent topic of scholarly study in recent years thanks to authors such as Anthony Atkinson whose impressive opus vitae has been dedicated to bringing the topic "in from the cold" (Atkinson 1997). One of the reasons for the increased attention to issues revolving around economic inequality is a steady and in some cases rather dramatic rise in within-country inequality, both in terms of its economic and political manifestations. With regard to the former, Atkinson, Piketty and Saez show that income inequality increased significantly since the 1980s in the English-speaking countries, which the authors attribute to ever-increasing top wage shares (Piketty and Saez 2003; Atkinson, Piketty, and Saez 2011; Atkinson 2015). While some European countries like France have resisted this trend, the same group of authors show that there is, in fact, a structural component to rising income and wealth inequality: Income inequality is crucially driven by capital income with historical evidence pointing towards rising levels of income inequality being due to increases in capital income and vice versa (Piketty and Saez 2014). Wealth inequality, in turn, can be seen as a function of rising rates of return on capital compared with relatively low growth rates in total economic output. Piketty famously distilled this insight in his 2014 bestselling book *Capital in the Twenty-First Century* (Piketty 2014).

Of course, considering income and wealth inequality as purely driven by structural factors is a great oversimplification, as Piketty himself pointed out his latest book *Capital and Ideology*, instead arguing for the necessity of a deeper understanding of ideational factors underpinning a political regime that allows for certain levels and structures of economic inequality (2020). Indeed, it is clear that one cannot ignore the decisive impact of redistributive policies with regard to levels of income inequality in the advanced capitalist democracies. Any analysis of rising inequality must, therefore, also take into account its political manifestations centred around the decline of redistributive policies such as taxes and benefits (Bartels 2018; Hacker and Pierson 2010). Much of the work on the political manifestations and determinants of rising income inequality and wealth inequality has put forth the argument that democratic capitalism is rigged due either to tax laws biased in favour of protecting the incomes and wealth of the highest earners or due to the capture of political elites by big business, who are then able to lobby for looser regulations and the easing of their share of the tax bill. However, recently, a contrasting argument has (re-)emerged, which questions such accounts of democracy working only for the rich. Instead, it reaffirms the notion that democracy and capitalism in fact work together to serve the median, or decisive, voter and, by extension, middle class interests above all else (Iversen and Soskice 2019). The following provides a review of the existing political science and political economy literature on the causes of different patterns of inequality and redistribution in the advanced capitalist democracies.

This literature can be understood through the lens of a *Model of Constrained Partisanship* as recently put forward by Beramendi, Häusermann, Kitschelt and Kriesi (2015). The model conceives of social and economic policies as a product of a combination of both demand and supply side politics. In other words, governments are, on the one hand, guided by electoral politics, i.e. the demand side of politics, structured around and constrained by the well-known cleavages among the electorate (building on the seminal work of Lipset and Rokkan 1967). On the other hand, policies are determined to a significant degree by constraints stemming from the supply side of politics, including the institutional framework of the polity, which includes institutionalised demands made by voters in previous rounds of policy-making such as different elements of the welfare state. Among the vast literature on the politics of inequality and redistribution, we can attribute the various insights to either of the two sides of this model, focusing either on the role of voters in pushing governments into particular patterns of redistribution, or institutions constraining policy makers' actions for instance by structuring certain electoral cleavages or limiting policy makers' options through pre-existing redistributive policies.

One line of argument regarding how and why governments redistribute, which directly speaks to the demand side of politics, is that redistribution outcomes depend on the crucialness of the hypothetical voter in the middle of the income distribution, which affects powerful political coalitions and thus whose votes must be captured by aspiring government parties. Initially posited by Downs (1957), the median voter theorem states that the distribution of pre-fisc incomes is right-skewed. In other words, the median voter's income is below the mean income, meaning governments are pushed by this average voter for ever more redistribution from higher to lower incomes until equilibrium is reached at the point where the costs of work disincentives through taxation are on par with the benefits from higher levels of redistribution.

Romer (1975) and Meltzer and Richard (1981) ("RMR"), in an important subsequent development of this argument, have shown that the median voter theorem can thus be utilised to explain increasing levels of redistribution through taxes and benefits. In a more modern iteration, Iversen and Soskice (2019) have once more stressed this line of thinking, arguing that, in capitalist democracies, groups closest to the middle of the income distribution are politically the most powerful as they constitute the so-called "decisive voters" who are in a powerful position to demand re- and pre-distributive policies. Importantly, this does not necessarily mean that governments are pushed towards more equitable policies per se and from the point of view of every voter. Rather, in one of the most pointed sections of their book the authors state that "the winners from advanced economies are typically the decisive voters [...] The essence of democracy is not redistribution or equality, as so commonly assumed, but the advancement of middle class interests" (ibid., 19).

A different strand of this literature with a somewhat more elaborate conceptualisation of electoral cleavages (see Lipset and Rokkan 1967) is centred around the social affinity hypothesis. Since the original formulation of the RMR model, a number of authors have pointed out that the empirical conclusions of the model are problematic: Indeed, according to the RMR model, societies with higher levels of inequality should also display higher levels of redistribution.

Empirically, this does not hold, with some of the most unequal societies among the advanced capitalist democracies such as the United States also redistributing the least, a phenomenon described by Lindert as "Robin Hood paradox" (Lindert 2004, 15). In essence, the various arguments put forward in the literature addressing the Robin Hood paradox through electoral cleavages are based on the question how congruous different voter groups are with regard to such cleavages and their position on the income distribution. For instance, Alesina and Glaeser argue in their analysis of how race and ethnicity affect patterns of redistribution that "when there are significant numbers of minorities among the poor, then the majority population can be roused against transferring money to people who are different from themselves" (Alesina and Glaeser 2004, 134). Various authors show that the social affinity hypothesis holds true for a number of electoral cleavages and how well they map onto the income distribution, including class (Shayo 2009) and religion (Scheve and Stasavage 2006).

In an important contribution by Lupu and Pontusson, this argument is expanded further. The authors show that rather than the level of inequality it is its structure that is decisive for how much redistribution voters demand from governments. In other words, social affinity increases when voters from different income groups are less distant from one another in terms of absolute income levels, translating into stronger demands for redistribution and vice versa. Thus, voters from low and middle income groups are more likely to form an alliance and demand redistribution from high income groups if there is less distance between the former two, and more distance between them and the latter. The opposite is true when incomes are more dispersed at the bottom and less so at the top, in which case middle income voters are more likely to ally themselves with affluent voters to whom they feel a higher degree of social affinity than to low income voters who are more distant from them (Lupu and Pontusson 2011).

Turning to the supply side of politics, authors have pointed out the significance of ideological colours of the political power in government as another key explanation for what shapes redistribution decisions and, by extension, inequality (Boix 1998). For example, Bradley et al. (2003) in their study of what determines outcomes for inequality found that having centre-left governments in office was by far the most important determinant of higher levels of redistribution, both directly through fiscal policies and indirectly through the parties' impact on the general size of the welfare state. It is important to once more point out the salience of the Robin Hood paradox and the relevance of absolute levels of inequality in this context. Rueda and Pontusson show that as societies grow more unequal, voters of left parties are moving further to the left on the economic policy dimension thus pushing the respective parties towards more redistribution. However, whether that actually translates into more redistributive policies depends crucially on the channel of mobilisation among low-income voters. Indeed, in cases where, as inequality increases, voter turnout among the less affluent declines, left parties will not espouse higher levels of redistribution (Pontusson and Rueda 2010).

Combining the insights regarding the decisiveness of both the party in power and the decisive role of the median voter (in a more simplistic conception of electoral cleavages and not considering the structure of inequality), the importance of electoral systems in shaping the voting behaviour of decisive voters in the electorate has been offered as an explanation to varying levels of redistribution across the advanced capitalist democracies. Iversen and Soskice (2006) argue that the nature of the electoral system is, in fact, definitive for levels of redistribution. Utilising data from 1945 to 1998, they show that countries with Majoritarian electoral systems have led to centre-right governments 75 per cent of the time, while for Proportional Representation (PR) countries almost the reverse-image is true, with 26 per cent of governments being from non-left wing parties. As centre-left governments tend to redistribute more than centre-right governments, Iversen and Soskice deduce that nations with PR systems are conducive to higher levels of redistribution, and thus lower inequality.

This in turn rests on the notion that, in order to command a parliamentary majority, governments need to capture voters in the middle of the income distribution. The key insight put forth by Iversen and Soskice is that governments in Majoritarian systems, typically constituted by a single party, will drift away from the centre after the election, while this is prevented in PR systems by the possibility of a coalition partner representing the middle of the income distribution withdrawing from the coalition. On this basis, voters in the middle of the income distribution are more likely to form electoral coalitions with higher income groups in Majoritarian systems. This is because, given the likely drifting of the government to the left or right, voters in the middle of the income distribution fear a left government distributing income from themselves towards the poor more than they value the possibility of the same government redistributing from the rich to both the middle and the poor and thus prefer a right government redistributing less per se.

At this point it is important to note that these theories are all based on democratic processes of policy making where elected governments are trusted with enacting policies on the behalf of voters. With regard to the object of study in this thesis, which relates to the Economic Adjustment Programmes overseen by unelected technocrats, the dynamics determining the distributive effects of the analysed reforms may be radically different. In fact, since all of the literature is based either directly or indirectly (e.g. through constraints posed by the electoral system) on the notion of accountability towards voters, it is essentially impossible to infer from this literature any predictions regarding how unelected technocratic policy makers solve distributional conflicts. For that purpose, papers 1 and 2 of this thesis explore the role of ideas and interests in shaping the policy prescriptions of unelected technocrats in the European Commission, the International Monetary Fund, and the European Central Bank.

A.2.3 Labour market inequality

Importantly, inequality has many different dimensions. Next to income inequality, for particular interest of this thesis is labour market inequality, given the substantial transformations of domestic labour markets induced by the comprehensive reform programmes administered by the Troika and the salience of the question how the adjustment burden was distributed among different labour market groups. The notion of labour market inequality for the purpose of the analysis presented in this thesis relates to different degrees of vulnerability to the possibility of becoming unemployed and the negative consequences associated with it.

Inequality within labour markets has grown in the advanced capitalist democracies since the late 1970s. On the one hand this has been the result of a number of structural changes pertaining to: an increasingly integrated world economy associated with rising competition from low-wage countries displacing low-skilled workers in the advanced capitalist democracies (Rodrik 1998); the tertiarization of the economy shifting large numbers of workers from well-paid and well-protected industry sector jobs to less protected and more unequally paid service sector jobs (Iversen and Cusack 2000; Iversen and Wren 1998); related to that, an increase in the share of women entering the labour market as they work primarily in service sector jobs and are more likely to interrupt their careers to tend to their families (Estévez-Abe 2005; Oesch 2006); and large-scale technological change, which has predominantly affected low-skilled workers and workers in routine-based occupations (Autor, Levy, and Murnane 2003; Autor, Katz, and Kearney 2006).

On the other hand, however, a growing degree of dualisation in domestic labour markets of the advanced capitalist democracies is related to concrete legislative changes resulting in the formation of two increasingly distinct groups: (1) a core of well-protected insiders in stable forms of employment who enjoy a high degree of job protection and easy access to generous benefits, and (2) a significant group of outsiders in atypical forms of employment, often with temporary work contracts, restricted access to benefits, and high vulnerability to becoming unemployed due to a lower degree or limited coverage of employment protection legislation (Emmenegger et al. 2012). Naturally, these groups form distinct and usually opposed preferences regarding legislative changes in the labour market and influence policy makers in one direction or the other: Insiders tend to favour stricter labour market regulations, which forms the basis for their own protected status, while outsiders view such regulation as entry barriers to high quality jobs (Emmenegger 2009; Saint-Paul 2002). For this reason, policy makers play a key role in cementing labour market dualisation by catering to the usually larger and better organised number of insiders and their distinct preferences (Rueda 2005; 2006; 2007; see also Ebbinghaus 2006; Emmenegger 2009; Häusermann and Schwander 2012; Iversen and Soskice 2009).

A.2.4 Technocracy versus democracy and the role of ideas and interests in shaping distributional outcomes

Both with regard to income inequality and the way in which market incomes are redistributed through the functions of the welfare state, and labour market inequality pertaining to differences in labour market regulation for different groups, one common trend emerges: In the advanced capitalist democracies, elected governments play a key role in influencing these inequalities through purposive legislation. Specifically, all of the above theories boil down to the notion that office-seeking politicians aim to present policies that cater to the needs of certain groups in the populace (be they their own voters, the median voter, or well-organised labour market insiders), to curry favour with them, ultimately in pursuit of their own election-seeking interests. The question that then becomes interesting is, what happens to decisions about redistribution and outcomes of inequality if the motivation for electoral victory is removed from the equation – i.e. if policies are made not by democratically elected officials but by unelected technocrats.

In the absence of exposure to electoral retribution from certain key voter groups for unpopular policies, such as tax hikes, pension cuts, or deregulatory labour market reforms, which are perceived as failing to respond to these groups' needs, technocratic policymaking is guided by different motivations. For precisely this reason, the economic adjustment programmes governed and instituted by the technocratic, unelected Troika of the IMF, the European Commission, and the ECB provide unique and revealing cases for understanding how technocratic governance of policies affects redistribution and inequality. Conversely, by providing distinctly different cases to phases of economic adjustment administered by elected politicians, they also allow us to further our understanding of the wider relationship between democracy and different forms of inequality.

The involvement of technocratic policy makers in policy decisions essential to distributive issues could go in two possible ways: (1) if we subscribe to the view that democratic processes and voter responsiveness force policy makers to redistribute progressively from the rich to the middle and/or the poor, then taking the electoral component out of the equation could mean that we observe less redistribution and more inequality (since nobody forces technocrats to redistribute; they are not held to account by any particular group among the citizenry). However, we also know that the same democratic processes can sometimes be an impediment to efficient redistribution, especially towards groups that wield less political power, which are typically concentrated at the lower end of the income distribution and/or in atypical forms of employment, instead choosing for instance to preserve the benefits and statuses of the voter in the middle of the income distribution or those that constitute the group of labour market insiders. In other words, democratic processes do not necessarily lead to better outcomes for the most vulnerable, both in terms of income and labour market status, since office-seeking politicians tend to be less responsive to their needs. Therefore, an alternative view could be that (2) technocrats are unfettered, too, by these dynamics and are therefore at liberty to redistribute in whichever way they deem beneficial without having to cater to certain voter groups. The ramifications of these two possible effects of technocratic involvement in (re-)distributive policies are enormous, as the exact effects are difficult to predict and could take extreme forms. It is therefore essential to understand the motivations governing the actions of technocratic policy makers.

To comprehend these motivations of appointed technocrats that are not held to democratic account and thus eschew the usual strategies followed by office-seeking politicians, a credible claim can be made, which is postulated in this thesis and corroborated by evidence, that the technocratic Troika institutions are motivated in the first instance *less* by interests (i.e. the desire to be re-elected), and instead *more* by ideas, in this specific case of whatever they deem to be ‘good’ economic policy. Depending on the conception of their ideas of what amounts to good economic policy, then, we can imagine that this can go in one of two ways: (a) less redistribution overall, (if the technocrats’ idea of good economic policy does not incorporate strong redistribution); or (b) more or “more efficient” redistribution (if their views of good economic policy feature a strong social dimension, for whatever reasons).

Following (a), we can comprehend why in the past we have observed far-reaching negative redistributive effects of, for example, IMF and also World Bank loan deals and attached conditionality programmes in lower-income regions of the world such as Africa and Asia, especially in the 1990s and early 2000s (Blanton, Blanton, and Peksen 2017; Forster et al. 2019). Unconstrained by voters forcing them into redistribution, and following their own idea of "good" economic policy, which from the 1980s up until the aftermath of the Great Recession incorporated distinctly market-liberal principles and a more minute role for the state (leaving little room for potential redistribution), inequality rose in the developing economy programme countries. This policy agenda of greater privatisation, market liberalisation, and fiscal retrenchment was a reflection of the economic orthodoxy of its day, of what constituted "sound economic policy", and was thus adopted by international technocratic organisations such as the IMF. However, ideas about what makes for good policy are open to change (Béland 2009; Carstensen and Schmidt 2016). Hall (1993) for example illustrates how British macroeconomic regulation policy transformed wholesale in the period 1970 to 1990 from Keynesianism to monetarism as a consequence of social learning processes within the state apparatus, occurring as a result of reflection and lesson-drawing from past policy experiences. Ideas are powerful, especially when conflicting interests are rendered ineffective, and shifting ideas based on past lessons can propel a step-change in future economic policies. Therefore, it is important to assess what recent ideas were within the Troika, not least between the two sets of actors coming from the US and Europe respectively (i.e. differences between the ideational preferences of the IMF as opposed to the European Commission and the ECB), to appraise what their consequences for different policies would be and how this would ultimately affect income and labour market disparities.

Examining policy preference contents and formation of the IMF and the European institutions of the Troika, this thesis finds that the IMF underwent a shift in their definition of good economic policy, specifically in relation to their understanding of income inequality, but less so with regard to their views regarding labour market inequality. The Commission, similarly, identified during the reform process in the economic adjustment programme for Greece that the social impact of the reforms was a salient issue, emphasised expressly by a number of its top-level Commission officials including presidents José Manuel Barroso and Jean-Claude Juncker. The two cases of the IMF and the European Commission and their ideational standpoints are now explicated further.

The IMF changed its comprehension of what type of economic policies can bolster long-term sustainable growth to incorporate measures abating inequality, as inequality is increasingly seen as a stumbling block to growth, and as redistribution is distinguished as a valid means to address this problem. This was ultimately the result of both institutional learning from the experience of the East Asian Crisis of the late 1990s, which led to the IMF's legitimacy being questioned to a point where it threatened its institutional foundations (Chwieroth 2009), as well as the substantive shifts in economic orthodoxy following the global financial crisis (Auerbach and Gorodnichenko 2012; Ban and Patenaude 2018; Clift 2018; DeLong et al. 2012). Adapted from the Kaleckian notion that lower income households have a higher marginal propensity to consume and spend a higher proportion of their disposable incomes, the IMF shifted its rather hawkish stance that progressive fiscal policy would result in an equity-efficiency trade-off, and gradually subscribed to the idea that using redistribution as a legitimate tool – a means to an end – would ultimately stimulate higher growth through reducing inequality (see e.g. Berg and Ostry 2011; Ostry, Berg, and Tsangarides 2014; Lipton 2013). Moreover, while accommodating continuous internal struggles of pluralistic ideas, the IMF is ultimately a hierarchical organisation. Thus, once a new set of ideas, such as the one assigning a more prominent role to redistributive policies as a means to tackle high levels of inequality, which are seen as impediments to long-term economic growth, takes hold and supersedes previously dominant ideas, this will quickly manifest in concrete policy proposals (Copelovitch 2010; Momani 2007).

Charting the journey of ideational evolution in the European Commission is more complicated as a stronger aspect of self-interest is involved. The Commission is arguably the most political out of the three Troika institutions, due to its proximity and accountability to the constituent EU member states, and furthermore because it suffers from a democratic input deficit (Follesdal and Hix 2006), and thus rests solely on its output legitimacy, meaning it is compelled to afford more attention to the social consequences it produces for member states. Despite considerations of augmenting output legitimacy to compensate for the democratic deficit, the process of European integration has in the past been characterised as a market-liberal as opposed to a socially conscious project, with a process of deregulatory integration across member states thanks to the rolling out of the Single Market, and a concomitant expansion of EU-level competences in more policy areas pushed through by a proactive European Court of Justice, also referred to as the negative integration bias of the EU (McNamara 1998; Scharpf 2010; Schmidt 2005; see also Beckfield 2019).

Beyond the effects of the IMF's and the European Commission's previous policy stances on inequality, entering into the single currency union has itself had consequences for inequality, too. The workings of EMU for inequality can be gleaned from the Maastricht convergence criteria, placing strict upper limits on members' state budget deficits and national debt levels. Having been labelled a model that encourages 'austerity forever' (Stierle and Haar 2012) or 'perpetual austerity' (Iversen and Soskice 2018a, 258), the stringent fiscal rules of the Stability and Growth Pact can be regarded as impinging on national welfare state expenditure, necessitating cuts in social policies targeted mostly at those nearer the lower end of the income distribution, and thus increasing risk of growing inequality. Eurozone member countries, having handed monetary policy competences over to a highly independent central bank, find themselves no longer able to pursue competitiveness or growth through currency devaluations, interest rate cuts, or generous Keynesian-style demand management. Instead the incentives are biased in favour of cutting taxes to galvanise growth, creating a continued need for public spending limits (in the face of lower tax revenues) to ensure the EMU debt and deficit criteria are still heeded (De Grauwe 2013), and thus impinging on national welfare states' abilities to protect the poorest.

In spite of this view that European integration has fostered continued convergence on a more laissez-faire common model for EU member states, other evidence focusing on the microlevel motivations of civil servants working for the European Commission indicates that so-called 'Eurocrats' (Geuijen et al. 2008) have a stronger penchant for policies based upon a more regulated form of capitalism. Hooghe (2000; 2001) and Ross (2011) find that Commission bureaucrats are actually in favour of enshrining a stronger social dimension in the European integration project characterised by more generous social services and higher levels of redistribution. In the Eurozone crisis, the key priority for the Commission was to achieve economic recovery and fiscal consolidation in the EAP-recipient countries, not least because the crisis constituted a threat of the Eurozone breaking up, with potentially disastrous effects for the whole European integration project; the role of inequality and redistribution (and therefore a recalibration of the welfare state) was therefore further down their list of priorities. However, as there is no negative relationship between the two (achieving consolidation and recalibrating welfare states to make them more progressive), the latter did find its way into the EAPs. For the Commission, this is most marked when we consider the third economic adjustment programme for Greece: after the IMF exited, thus allowing for a more direct evaluation of the preferences of the Commission in particular, the programme included a whole report on the social impact of the reforms, which Commission President Juncker stressed was a salient issue for the Commission. In that sense, the economic adjustment programmes can be viewed as what Mahoney and Thelen (2010) refer to as 'soft spots' in the historical institutionalist sense; they are policy areas that can be utilised by agents to achieve gradual change (see also Streeck and Thelen 2005; Thelen 2003; 2009), which Commission bureaucrats seem to have exploited to enshrine a stronger social dimension in the reform programmes, while maintaining the overall goal of achieving fiscal and economic adjustment.

A.3 Research Design

This thesis analyses and explains the distributive effects of different economic adjustment policies, including austerity measures such as tax hikes and benefit cuts as well as labour market reforms. At the heart of this analysis lies the question how policy makers in the Eurozone crisis distributed the burden of adjustment across different income and labour market groups in the face of the distributive conflicts arising from the pressure to (1) consolidate public budgets, and (2) implement structural reforms aimed at restoring cost competitiveness. In the first step of the analysis, it is, therefore, required to accurately measure the specific effects of the reforms on (1) the income distribution, and (2) labour market segregation before any assertions as to the roots of the observed effects can be made. The problem of accurate measurement, however, is not a trivial one. In fact, changes in the distribution of income as well as the segregation of labour markets can be caused by a multitude of different and interdependent factors of extreme complexity. Measuring precisely how any given reform impacted a specific outcome, such as income inequality, in the face of a complex set of factors, therefore, requires the careful construction of counterfactuals, which in turn necessarily requires assumptions to be made. In the second step, the thesis explains the observed outcomes, asking in particular the question of how the involvement of the Troika impacted the reform process, the specific design of the reform measures, and by extension the distributive effects of these reforms.

In order to make sense of this complex interplay of different factors, the thesis constructs a comparative case study of two countries, Greece and Portugal. Both countries were hit hard in the Eurozone crisis and became part of Troika-administered economic adjustment programmes. The thesis is set up as a *most similar systems design case study*, which allows both for the accurate measurement of the dependent variables, and the discernment of the specific effect of the Troika involvement on the distributive outcomes of the reforms. This section serves to (1) justify the case selection and substantiate the case for a most similar systems design comparative case study, which includes an analysis of the country-specific dependent variables, and the comparability of the relevant independent variables identified in the literature review section of this introduction; and (2) outline of the methods used to measure the reform effects and ascertain the impact of the relevant independent variables

A.3.1 Case selection

Firstly, for the purposes of this project's ambitions, it makes sense to exclude from our purview other Troika bailout recipient countries aside from Greece and Portugal. This will now be explicated by process of elimination. Next to determining the precise distributive effects of austerity measures depending on their design and composition, the object of interest is the specific impact of Troika involvement in the programmes, which disqualifies for example Italy, which did not receive a Troika programme. Furthermore, the inclusion of Spain is inappropriate too, as the country did much to avoid a Troika programme with conditionality at almost all costs. It underwent only a financial sector adjustment programme, rather than a complete economic adjustment programme, and thus did not go through Troika-prescribed deep and far-reaching fiscal and structural reforms. Spain undertook austerity almost proactively, which also allowed the country to retain its autonomy with regard to how policies should be designed. The case of Spain is therefore not conducive to gauging the effects of Troika involvement. This leaves Ireland, Cyprus, Greece, and Portugal. Ireland is wholly dissimilar to the latter three countries, having a radically different (liberal) welfare regime, making it impossible to sufficiently restrict for purposes of causal attribution the diversity among possible independent variables with regard to explaining the causes of the different distributional effects. Meanwhile, taking Cyprus into account would also reduce comparability, owing predominantly to its drastically smaller size.

In addition to excluding other country-case possibilities, there are also important reasons in favour of the explicit selection of solely Greece and Portugal for the purposes of this project's ambitions. It is important to note here that both countries were the most deeply affected by the sovereign debt crisis of any Troika country and thus party to the most drastic austerity measures. Both also had similar landscapes at the onset of the crisis, sharing important features. Afonso et al.'s 2015 study on how party linkages shaped the various responses to the crisis and fiscal adjustment in Greece and Portugal provides a case in point for the comparability of the two countries: both have similar levels of socio-economic development, both are part of the same family of welfare regimes (Ferrera 1996, this will be explored further in section 1.4.2 of this thesis), both are of similar size, both were democratised during the same period, and both joined the EU in the 1980s (Afonso, Zartaloudis, and Papadopoulos 2015).

Having sketched out the reasons why Greece and Portugal are the most apposite comparative cases, the following turns to the requirements of most similar systems case study design (MSSD) and illustrates how the two countries satisfy these conditions. Both countries are similar along a number of independent variables crucial to the prerequisites for a MSSD that could otherwise potentially explain distributional choices of policy makers. This includes their particular welfare state model, the so-called Southern European welfare state (Gosta Esping-Andersen 1990; Ferrera 1996; Hemerijck 2013; Rhodes 1996), the Mediterranean variant of production regimes (Amable 2003), a similar composition of welfare spending with regard to discretionary expenditure or entitlement spending, which can in turn determine which expenditure items are easiest to cut (Breunig and Busemeyer 2012; Clayton and Pontusson 1998) and their electoral systems (Iversen and Soskice 2006; Persson and Tabellini 2004). Partisanship is one possible explanatory variable on which the cases differ: While both the Greek and Portuguese EAPs were initially negotiated by centre-left governments, the Portuguese programme was ultimately implemented by a centre-right government from 2011 onwards. In Greece, there was much more dramatic reshuffling of the political landscape, and throughout the duration of the EAPs the country saw frequent changes in the government in power, from centre-right to far-left coalitions. While this would ordinarily have to be considered as a possible explainer for potential differences in the distributive effects of the EAPs, this potentiality can be safely rejected on the grounds that, despite the many changes in government in Greece, the distributive effects of the EAPs did not change after 2012 (see Paper 2 of this thesis), thus undermining the explanatory potential of partisanship for the matter at hand here.

Lastly, one key difference between the two countries, which the thesis identifies as the key independent variable explaining different distributive outcomes, is the degree of influence of the Troika over the reform process. In Greece, the

Troika controlled the reforms much more closely, prescribing specific policy measures, while in Portugal the reform prescriptions remained more general, outlining broad fiscal targets rather than strictly defined concrete measures. Moreover, pushback from the Portuguese was more effective (and perhaps more tolerated by the Troika), which relates to stronger veto points such as the Constitutional Court, the overall higher reform capacity of the Portuguese state, and the fact that Portugal returned to the long-term bond markets sooner than expected, thus effectively ending the dependence on payments from the Troika.

Given that the preferences of the technocrats of the Troika and those of elected domestic policy makers regarding redistribution and inequality more generally follow different logics, as shown in the previous section, the divergent degrees of Troika control over the reform process is thus a powerful explanation for possible differences in the distributive effects of the programmes.

A.3.2 Measurements, data, and methods

The thesis first focuses on the income dimension of inequality as the key dependent variable. In order to assess the effects of the reform programmes on income inequality, it draws on microdata from the *European Union Statistics on Income and Living Conditions* (EU-SILC) database, which is the most comprehensive data source available for European countries. On the basis of this data, inequality is measured in aggregate terms using the Gini coefficient and the S80/S20 ratio. These indicators are chosen due to their mutually complementary nature: The Gini coefficient, calculated by dividing the area between the Lorenz curve and the 45° line of equality by the area below the line of equality, is a powerful instrument for capturing changes in the middle of the income distribution. However, one of its weaknesses lies in the underrepresentation of changes at the tail ends of the income distribution. The

S80/S20 ratio measures the ratio of the aggregate income of highest quintile of income earners by the aggregate of the lowest quintile. Therefore, it is particularly well-suited to capturing changes at the tails of the income distribution, thus neutralising the weaknesses of the Gini coefficient when used in tandem. Both indicators are calculated for incomes at the household level, both before and after redistributive measures (i.e. market and disposable income).

Furthermore, the thesis makes strong use of microsimulation techniques through tax-benefit microsimulation tool EUROMOD. The benefits of using microsimulation in conjunction with household-level microdata are vast: By constructing and comparing counterfactual scenarios, microsimulation allows the specific isolation of the distributive effects of policy changes from any effects of the wider recession (Bargain 2006; Sutherland and Figari 2013; for a more detailed explanation, see Paper 1, section 1.3.3). This means that microsimulation can be used to measure the precise effects of any policy reform that was part of the EAPs. Drawing on household-level microdata, and providing every tax and benefit policy in place in each year and country, this constitutes a major advantage over other econometric techniques that approximate the effects of certain policy reforms. This is of particular relevance in the context of the crisis, as the scope of confounding variables is immense; for instance, approximating the effects of a reform in unemployment benefits for income inequality during times where unemployment is growing rapidly is difficult. The use of microsimulation tools circumvents this problem by simulating the effects of the reform for each individual household's income and then calculating inequality measures on the basis of the newly created income distribution containing the policy change. The microsimulation data presented in this thesis are novel in that the specific effects of the EAP reform measures were simulated, thus allowing for new insights on the interplay of different policy reforms and inequality.

Moreover, aside from quantitative data, the thesis draws on evidence from the documents related to the EAPs, such as the Memoranda of Understanding, and the ex-post evaluation of the programmes compiled by the IMF and the European Commission, as well as public statements, speeches, and secondary interview data. This is both in order to describe and classify the negotiated and implemented reforms, and gauge the preferences of the different actors involved regarding the specific reform design.

With regard to measuring labour market inequality, the thesis again makes use of EU-SILC microdata, but at the individual level of workers. As the database contains information not just regarding a worker's income, but also a number of variables regarding her or his employment status, type of employment, type of employment contract, and working hours, the data can be used in order to attribute different labour market statuses to each individual, classifying them as either labour market insiders or outsiders. Further to providing a bird's-eye view of the degree of dualisation in each year, the data also allow for calculations of transitions between the two groups as well as the unemployed based on longitudinal panel data. Through this method it is possible to measure the group-specific unemployment risk for both insiders and outsiders by comparing the transition ratios from each group to unemployment (for a more detailed explanation, see Paper 3, section 3.3.2). In conjunction with the analysis of labour market reforms, this allows for important inferences regarding the reform effects in either alleviating labour market dualisation or further exacerbating it.

A.4 Synopsis and Contribution

The following provides a synopsis of the thesis as well as an outline of the contributions made in each part of the thesis. Testing for the effects of the reforms on income inequality and labour market duality in Portugal and Greece, the thesis first zooms into the trends in income inequality in the process of the reforms. Using EU-SILC data, the thesis first shows that, despite deep recessions in both countries, disposable income inequality measured by both the Gini coefficient and the S80/S20 ratio stagnated. At the same time, market income inequality increased significantly, revealing that throughout the entire duration of the reform programmes, redistribution through the welfare state was sufficient to offset these increases despite the deep cuts in benefits and other social expenditure. While this contradicts large parts of the public discourse about the crisis in Southern Europe, the observed development of income inequality may simply be a result of automatic stabilisers kicking in (although it is noteworthy that the austerity measures evidently did not retrench them in this regard) or other factors. Therefore, the thesis further tests the exact effects of the reform measures on the income distribution.

Using microsimulation techniques, the thesis uncovers surprisingly that, in contrast to expectations in the orthodox economic literature, the Troika-induced reforms had a specifically inequality-reducing effect in both economies. The thesis continues by decomposing the individual reform measures in order to identify which ones had the most progressive (and regressive) effects. In a contribution to the economic literature on the distributive effects of austerity measures, the thesis presents strong evidence that the composition of fiscal consolidation measures, i.e. to what extent they are based on expenditure cuts or tax increases, in fact matters little to how these reforms affect inequality. Instead, both types of reforms can be designed in either progressive or regressive ways, putting the exact design rather than the composition of austerity measures centre-stage. This is illustrated by changes in means-tested benefits, which had regressive effects in Portugal, but overwhelmingly progressive effects in Greece. Overall, this calls into question the findings of previous studies by e.g. IMF researchers claiming regressive effects of expenditure-based programmes. This is likely due to differences in the research design and showcases the benefits of using in-depth comparative case studies to qualify the correlations (e.g. between expenditure-based consolidation and higher inequality) found in large-n economic studies.

Moreover, although the general finding of progressive austerity measures is striking and unexpected according to the traditional economic literature on the impacts of revenue-raising and expenditure-cutting austerity for income inequality, the thesis pinpoints that the answer to this puzzle is nestled in the precise policy preferences for the reform packages formulated by two of the Troika partners – the IMF and the European Commission – which, as shown previously, are crucial for the distributive effects of the reforms. These actors stressed in the EAP-related documents the imperatives to afford protection to the lowest income groups in the population during the austerity process, for reasons of: protecting lowest income people from vulnerability, abating public pushback or resistance to reform implementations, and thanks to a belief in the soundness of progressive redistributive policies for securing sustainable economic growth (based on the notion of lower income households' higher marginal propensity to consume) and thus expediting both the economic recovery and, by virtue of this, the timely repayment of the loans. The thesis at this point presents evidence of both the preferences of the Troika actors gauged through the documents, secondary interviews, and public statements and speeches, and the ideational foundations for these preferences for both the Commission and the IMF. The Commission differs from the IMF in the important respect that it faces a dilemma between the political accountability towards the hawkish creditor countries of the Eurozone, acting as their agent in the reform process, and on the other hand its responsibility as a guardian of the Treaties in defending the European Social Model. Commission technocrats in particular therefore used the adjustment programmes to introduce a more strongly redistributive dimension in the countries' tax-benefit systems while, however, adhering to the overall austerity paradigm and not questioning the fiscal consolidation path that in particular Germany and its allies in the Council insisted upon.

Based on the two important empirical contributions that (1) austerity can have progressive effects, and (2) Troika officials especially in the IMF and Commission had a predisposition towards more redistributive policies, in the second paper, the project hones in on the income inequality data at a more granular level as well as testing for changes over time rather than comparing before and after scenarios of the EAPs. The paper finds that the effects of the reforms on incomes in Greece were, in fact, more progressive, i.e. more inequality-reducing, than in Portugal in that lower income groups benefitted from the reforms in Greece, while in Portugal it was mainly middle income groups that remained shielded from any adverse effects of the reforms. To disentangle why this has been the case, despite both countries receiving analogous austerity prescriptions and being examples of 'most similar systems', the project looks more closely at the Troika's more vigilant, closer involvement in the Greek case. The thesis presents evidence that this is traceable to Greece's historical track record of lower capacities of policy implementation, owing to endogenous problems in its governance and public administration system, as well as stronger clientelistic linkages between certain voter groups and the government. At the same time, there was more pushback against the reform prescriptions in the case of Portugal, pertaining to stronger domestic veto points such as the Constitutional Court being instrumentalised by the Opposition parties and the President, and the early return of the country to the long-term bond markets, tilting the bargaining game vis-à-vis the Troika back in Portugal's favour.

Variation between Greece and Portugal in the degree of unelected, technocratic, Troika-led policy oversight and execution as opposed to elected, democratic, domestic government-led policy oversight and execution is identified as the independent variable which explains the marginally greater progressivity of austerity in Greece. This is corroborated in particular by juxtaposing the degree of Troika control in Greece with the distributive effects over time: The documents reveal that the Troika only tightened its grip on the Greek reform programme in 2012 when major fiscal targets had not been met. Parallel to that, the distributive effects became more progressive at precisely this point, which constitutes a break in the trend of initially regressive reforms in the first two years of the adjustment process. Further process tracing reveals that the Troika's grip on the Greek reform process tightened further, and in particular during the Syriza administration, with distributive effects becoming more progressive. Importantly, this cannot be attributed to partisanship and the far-left Syriza government coming into power, as is illustrated through a brief case study on the major Greek pension reform, which had progressive effects but was met with adamant opposition from the Syriza government (and, in fact, watered down somewhat making it less progressive than the original proposal).

With regard to the broader implications for the interplay of democracy and technocracy with inequality, the answer to the diverging inequality outcomes can be found in the guiding logic of the two differing sets of actors. The Troika, being an unelected technocratic entity that is neither accountable to nor compelled to respond to the populace, is able to pursue more effectively what it deems to be superior economic policy ideas, i.e. in this case those that safeguard the lowest income groups for the sake of spurring economic growth, and thus in the longer term helping secure loan repayments. Due to Greece's flawed implementation record, therefore, the Troika wielded more power and control, and could more effectively push through more progressive fiscal measures. The democratically elected domestic government, on the other hand, was more firmly in charge in Portugal at least with regard to the exact design of the reform measures; the guiding logic was thus very different to that of the Troika's. National politicians are office and re-election seeking creatures, the pursuit of which, in turn, rests on currying favour with the 'decisive' or 'median voter' among the citizenry (Iversen and Soskice 2019). Thus, to the extent possible, domestic politicians will aim to execute painful adjustment measures in a way most amenable to the median income voter, as this group in the electorate is most decisive to the politicians' re-election prospects.

This constitutes one of the major conclusions of this thesis: unelected technocrats may be at liberty to implement inequality-reducing reforms, while elected governments are often not, due to their office-seeking nature and the need to protect certain important voter groups, which may come at the price of implementing less progressive or even regressive reforms. Two important qualifications need to be made at this point and are explored further in the thesis: (1) Technocrats are, of course, no knights in shining armour fighting to protect the vulnerable – the various IMF programmes up until the late 2000s have shown this well enough. Instead, technocrats are guided primarily by their ideas and interests, and if these align with more progressive policies, technocrats may be in a better position to implement such policies than elected governments that have to fear electoral retribution; (2) the mechanisms for elected governments that may keep them from implementing progressive reforms are not always be direct. As we know from Beramendi et al. (2015) and the growing electoral turn literature, governments are beholden to the will of the voters. However, and that is a blind spot of the electoral turn literature despite the fact that it is, in fact, theorised in the original Beramendi et al. contribution: Institutional constraints matter. In that sense, legacies from past policy making rounds may contribute to making it difficult for elected governments to implemented progressive reforms. A case in point is the rejection of the Portuguese pension reform and public sector pay cuts, both of which had progressive effects: In this case, it was not the government directly, but the opposition and the President that had brought the case to the courts, which then ultimately rejected the reforms, illustrating how constrained governments can also be by voters preferences from precious policy making rounds that were enshrined in institutions and national legislation.

Further to illuminating the effects of the economic adjustment programmes on the distribution of income in Greece and Portugal, in the third paper the thesis turns to a further key dimension targeted by the reform packages, namely structural reforms to the labour market. This is done to complement and extend our understanding of the effects of the reforms, in addition to testing whether, akin to the fiscal measures, labour market reform policies sketched by the Troika advanced the idea of safeguarding the most vulnerable population groups. One argument in this regard is that even if fiscal reforms had been progressive, labour market reforms may have had such negative effects for workers that the overall thrust of the reforms would still be described as regressive. The thesis provides evidence against this. Southern European countries' labour markets are denoted by heavy segmentation or dualisation in the literature, with privileges such as high employment protection and high severance pay set down in law and afforded to so-called labour market insiders, at the cost of greater entrenched job insecurity and precarity for labour market outsiders. The effects of the labour market reforms are chronicled in both Portugal and Greece, revealing that, where the Troika had less say in practice, i.e. in Portugal, the established insider-outsider dynamic remained broadly intact, underpinned among other factors by the Portuguese judiciary's assertion that sweeping labour market flexibilization could be deemed unconstitutional. In Greece, by contrast, a process of across-the-board deregulation and liberalisation began to take hold, pushing erstwhile insiders to outsider status and increasing their group-specific unemployment risk, while keeping outsiders in their original (vulnerable) position.

The contents of the labour market reform policies were, therefore, unlike those of the fiscal policy reforms, where the Troika had a predilection for protecting the lowest income groups, and applying this in practice where it exerted more control (in Greece). Whereas the IMF and the European Commission displayed a change in fiscal policy thinking (or at least an incompatibility with expectations in the orthodox economic literature), in the direction of seeking to proscribe large-scale income inequality as a means to maximise the chances of success of the programmes, in structural reforms of labour markets, a more traditional, more predictable, approach was adopted – one of deregulating and liberalising of labour markets for everybody.

This sheds light on an interesting finding. In line with the ideas, interests, and institutions framework for explaining policy change versus continuation, the differing degrees of progressivity of the reforms in both countries seems to endorse the relevance of especially the role played by ideas and interests in the austerity measures of the Eurozone bailout and reform programmes. The Troika, following what they deemed as sound economic policy *ideas* for bolstering more sustainable economic growth, applied fiscal reforms that would redistribute more to those in the lowest income deciles when they were presented with the chance of doing so in practice in the case of Greece, fearing no adverse democratic backlash by virtue of being unelected technocrats. The somewhat less progressive redistributive outcomes in Portugal, conversely, where national politicians exercised greater control over policy implementation, lends credence to the argument that democratically elected national officials followed their *interests*, shielding the median voter from the reforms as best they could to augment chances of staying in office. Similarly, the across-the-board deregulatory labour market reforms in Greece relate to an unchanged set of ideas held by Troika technocrats regarding the ideal design of labour market reforms, which does not accommodate compensatory measures for the most vulnerable workers, and relies predominantly on the idea that large-scale deregulation and the resulting higher flexibility of labour markets is more efficient and therefore provides the best preconditions for long-term economic growth.

In the next chapters of the thesis, the research is presented in three separate stand-alone papers. The thesis closes with concluding remarks outlining the key contributions of the research, a discussion of its limitations, and a brief discussion of important avenues for further research.

Paper I

Austerity, inequality and the Troika: A microsimulation approach to measuring the distributive effects of fiscal consolidation measures in the Eurozone crisis*

ABSTRACT

The paper analyses the fiscal consolidation measures that were part of the Economic Adjustment Programmes for Greece and Portugal and their effects on income inequality. Using EU-SILC microdata, the paper finds that inequality of disposable incomes did not rise throughout the duration of the reform programmes despite substantive increases in market income inequality paired with cuts in social expenditure. Further to that, the paper uses microsimulation techniques to measure the exact first order distributive effects of the fiscal reforms. It finds that both the Greek and Portuguese EAPs lowered inequality vis-à-vis the pre-reform tax-benefit system. Furthermore, the paper decomposes the reforms by policy class measuring their individual distributive effects. A key finding the paper presents here is that the design of the reform measures matter crucially for how they affect inequality, regardless of the policy class as which they are labelled. This constitutes a departure from the orthodox economic literature, which stipulates that it is the composition, i.e. whether austerity is based on expenditure cuts or tax increases, that defines the distributive effects of such reforms. Explaining the surprising finding of progressive austerity, the paper turns to the policy preferences of the Troika. In contrast to previous findings of institutions such as the IMF being associated with policies that increase inequality, the paper presents evidence of an ideational shift in the institutions, assigning a larger role to inequality as an issue, and identifying redistributive policies as valid instruments to tackle inequality.

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1.1 Introduction

By 2019, the European Economic and Monetary Union seemed to be returning to a state of political normalcy after almost a decade of economic turbulence and deep reforms to EMU economic governance. At the centre of the Eurozone crisis stood the requests for financial assistance by a number of member states forced by skyrocketing levels of public debt. In response to the bailout requests, the Troika of European Commission, European Central Bank, and International Monetary Fund negotiated large-scale austerity programmes with the recipient countries' governments in return for their financial assistance. These programmes led to mass protests in the recipient countries and were criticised almost uniformly in the scholarly literature. One major point of contention concerned the adverse effects of pro-cyclical spending cuts and tax increases on economic growth. Another one, which tends to be overlooked in favour of the former, is the impact of extensive austerity measures on the countries' ability to cushion the effects of the crisis on vulnerable income groups through the stabilising functions of the welfare state. The paper tests the validity of this critique by measuring and explaining the distributive effects of austerity programmes. It shows that, despite a number of much-cited economic accounts predicting rising levels of inequality as a result of such reforms, the adjustment programmes were in fact accompanied by higher levels of redistribution keeping inequality of disposable household incomes stable throughout the programmes.

The paper showcases this in a comparative case study of the Greek and Portuguese Economic Adjustment Programmes (EAPs), covering the entire duration of the Portuguese programme from 2011 to 2014, and the reforms under the different Greek programmes between 2010 and 2017. Specifically, the case study answers the question how the EAPs affected the redistributive capacities of the welfare states of the recipient countries, and the distribution of incomes in those countries. It does so by combining the use of household income microdata taken from the latest waves of EU-SILC surveys with data obtained through simulations run with tax-benefit microsimulation tool EUROMOD. In more detail, the data presented in this paper show that (1) inequality has not increased substantively throughout the crisis, (2) rather than being curtailed by fiscal consolidation pressures, the level of income redistribution in the recipient countries increased, and (3) the reforms implemented under the EAPs had a direct inequality-reducing effect, which, throughout most of the programmes, were large enough to offset the increases in market income inequality induced by the recession through e.g. higher unemployment.

Based on these findings, the paper offers insights into the interplay between the design and composition of fiscal consolidation measures and inequality that have so far been under-researched in the literature: Whether fiscal consolidation is achieved mainly through spending cuts or revenue increasing measures seems less crucial to the distributive impact of those measures. Instead, the critical factor is the exact design of the measures and the proportion of the adjustment burden that is put on higher incomes, as well as the degree to which the most vulnerable income groups are protected or compensated for income losses.

Rejecting the idea of an automatism between a particular composition of fiscal consolidation measures and their distributive impact, the paper argues that policy-makers are faced with choices regarding the design of the consolidation measures, which in turn produce different distributional outcomes. However, a large literature suggests that the Troika institutions in particular have in the past neglected the social dimension of fiscal consolidation measures and thus left this fiscal space unutilised in terms of achieving progressive distributive outcomes. The paper offers insights as to why this is not the case for the

European EAPs. It presents evidence that the Troika institutions put a strong focus on making the painful reform prescriptions as socially acceptable as possible, as is revealed in a number of policy documents such as the Memoranda of Understanding, the regular programme reviews, and the post-programme evaluation reports. The paper also argues that the Troika decisions regarding the distributive nature of the programmes were driven mainly by the Commission and the IMF and less by the ECB, which was primarily concerned with ensuring price stability as well as general fiscal prudence but had no stake in the distributive effects of the programmes.

Furthermore, the evidence suggests that the reasons for both the Commission and the IMF pushing for more progressive reforms varied: For the European Commission, the key goal was to not lose the brittle public support for the reform programmes and thus jeopardise their implementation in a political climate that was already hostile towards the painful reforms. For the IMF, conversely, the paper presents evidence that views within the Fund habe been shifting from an agnostic to a more concerned stance towards high levels of inequality. This mirrors in part the concerns of the Commission to maintain public support in order to be able to implement necessary reforms. In addition, however, this concern is based on a more general understanding developed since the East Asian Crisis and in particular the GFC that high levels of inequality are harmful to long-term economic growth and that stronger and more efficient redistributive policies can boost economic activity.

The paper is structured as follows. The next section outlines what the scholarly literature tells us about how fiscal consolidation programmes affect inequality, as well as showing how the economic policy consensus of the Troika partners was likely to result in a composition and design of the EAPs that, based on previous findings, was expected to lead to higher inequality. This argument is grounded in a discussion of the EU's economic policy consensus, as well as economic necessities rooted in the incompleteness of the Economic and Monetary Union. The third section provides the rationale for choosing Greece and Portugal as case studies, being countries that ultimately differed greatly in the composition of the fiscal consolidation measures they were prescribed. The section continues by outlining the methodological approach of the paper including the use of tax-benefit microsimulation tool EUROMOD as well as explaining the indicators used to measure income inequality and presenting the datasets. The fourth section presents the empirical analysis and discusses evidence from policy documents, interviews and official statements by Troika bureaucrats regarding the different institutions' stance on inequality and redistribution.

1.2 Theoretical Considerations and Case Selection

1.2.1 Understanding the crisis management of EU policy makers – the political economy of European austerity

The crisis management in the Eurozone was determined by the policy consensus that shaped and was shaped by the European integration process, the economic necessities emerging from the unique intricacies of an incomplete Economic and Monetary Union, and the politics of the Eurozone crisis. In conjunction, these three factors explain why the uniform response to the sovereign debt crisis was centred around immediate and severe austerity measures targeted at increasing government revenues, but even more so cutting public expenditure.

The European project is often described in the literature as following 'neoliberal' principles (McNamara 1998; Scharpf 1999)[13]. While McNamara argues this for the case of monetary policy, there is no doubt that the emerging consensus in that area also had a profound effect on fiscal policy by prioritising price stability over other policy objectives: Strict fiscal rules had to be created so as to not jeopardise the overarching aim of price stability. Overall, the emerging policy consensus was in line with the global shift from Keynesianism to Monetarism (Hall 1993), and an adherence to policies subsumed under what came to be known as the Washington Consensus (Williamson 1990). These principles were ultimately enshrined in the Maastricht Treaty, the Stability and Growth Pact (SGP), and more recently the Fiscal Compact (De Grauwe 2018; Fitoussi and Saraceno 2013) leading some commentators to coin the term Brussels-Frankfurt Consensus (Sapir et al. 2004) and Brussels-Frankfurt-Washington Consensus (Fitoussi and Saraceno 2004).

In the resulting policy regime, on the monetary policy side, the European Central Bank was tasked with ensuring price stability as its prime objective and equipped with unprecedented independence from national governments as per Articles 104(1), 105(1), and 107 of the Maastricht Treaty (*Treaty on European Union* 1992). On the fiscal policy side, EU member states agreed to adhere to the strict fiscal rules of the SGP and later the Fiscal Compact, which maintained the SGP's maximum level of public debt at 60% of GDP but in addition stipulates that governments balance their budgets over the business

[13] Scharpf argues that European integration is characterised by a bias towards negative integration, i.e. de-regulation rather than re-regulation, which in turn rests on the inherent impediments of positive integration in a quasi-federal setting, which he describes as the joint-decision-trap (2006) as well as the institutional asymmetry of the EU, which is stipulated by the notion of "integration through law" (S. K. Schmidt 2012). As a consequence, Scharpf argues that EU member states would converge towards an integrated liberal market model (2010; see also Esping-Andersen 1990; Hall and Soskice 2001).

cycle regardless of absolute debt levels[14] (European Union 2012). Government expenditure and the room for fiscal manoeuvre was thus limited for EMU member states already before the onset of the Eurozone crisis and even more so after fiscal rules were tightened further.

While the policy consensus that was built around the prioritisation of price stability and adherence to strict fiscal rules lays the ideational and institutional groundwork for general fiscal restraint, it fails to explain the timing of the deep austerity measures implemented in the Eurozone crisis. In other words, why did policy-makers choose to employ such measures in an already struggling economy despite the fact that this could reasonably be expected to further stifle economic growth? In this regard, it is necessary to understand the unique intricacies stemming from the incomplete design of the Economic and Monetary Union.

Ordinarily, when faced with an economic shock inducing a liquidity or even solvency crisis, there are broadly speaking three options amongst which policy-makers can choose in order to achieve the necessary adjustment, provided that default is not an option[15]: (1) stimulating demand through expansionary fiscal or monetary policy, (2) currency devaluation, and (3) austerity through increasing government revenues or cutting public expenditure (Matthijs 2016). However, with the room for fiscal manoeuvre being extremely limited for EMU member states under the restrictions of the SGP and Fiscal Compact, the possibility for substantive demand stimuli through expansionary fiscal policy over a longer period of time was foreclosed as a viable policy option. Moreover,

[14] The Fiscal Compact specifies that a 'balanced budget' is achieved when a country's structural deficit, i.e. its general deficit minus the impact of the economic cycle on government spending and revenue, is at 0.5% of GDP or lower.

[15] For the sake of the argument it is assumed that a default of one country was not a realistic option for policy-makers in the Eurozone crisis due to the risks of contagion effects in the common currency area.

since governments of EMU member states have no direct control over the common currency or the ECB, both currency devaluation and unilateral expansionary monetary policy are impossible. Effectively this leaves austerity as the only feasible instrument in the adjustment process. In addition, the fact that the pre-OMT ECB is unable to act as a lender of last resort that provides EMU member states with liquidity to service their debt gives rise to the threat that even member states with healthy public finances may face a solvency crisis as a result of a simple liquidity crisis, which exacerbates the need for immediate austerity measures (De Grauwe 2013).

Despite the ideational and institutional factors contributing to the primacy of austerity as the dominant policy response to the Eurozone crisis, creditor countries could have softened the need for fiscal consolidation in the Eurozone periphery through expansionary fiscal policy of their own. In other words, internal devaluation in the debtor countries could have been offset to some degree by inter revaluation in the creditor countries, particularly those with large current account surpluses such as Germany. This approach would have likely resulted in a lower loss of output and moderated the severity of the austerity measures in the debtor countries. The refusal by the creditors to do so, and in turn chart a course of fiscal consolidation, themselves, was due to three factors: (1) a misdiagnosis of the sovereign debt crises in the periphery as crises of competitiveness and government profligacy, (2) the political clout of ordo-liberal ideology in Germany, and (3) a lack of political capital in those creditor countries that could have otherwise opposed the group of fiscal hawks led by Germany.

For the political elite in Northern European countries, and most importantly Germany, the crisis in Southern Europe and Ireland was the result of profligate governments that aside from overspending had failed to implement structural reforms throughout the years leading up to the crisis (Blyth 2013; De Grauwe

2013). This was fuelled by the powerful narrative, dominant mainly among German conservative politicians, that the economic success of Germany in the recent years was due to the sweeping labour market and fiscal reforms implemented by the Schröder government in the early 2000s, leading the country from being the 'sick man of Europe' to its economic powerhouse. Despite the limited comparability of the German case with the crises in the Eurozone debtor countries, German politicians pushed for similar reforms to become the cornerstone of the response to the Eurozone crisis (Scharpf 2013, 134f.).

Ideologically, the misdiagnosis of the crisis and the resulting push for deep austerity measures and supply-side reforms was rooted in Ordo-liberalism, the German variant of market liberalism (Bonefeld 2012). The fact that Germany was the first EU member state to have broken the deficit rule of the Stability and Growth Pact in 2003 but now pushed for the strict adherence to fiscal rules was entirely in line with this ideological foundation. After what was perceived as a painful but necessary reform process, Germany had enshrined the so-called 'Schuldenbremse' (debt break) in its constitution in 2009, prohibiting deficits above 0.35 per cent of GDP. The German political elite, however accurately or not, considered the combination of ordo-liberal supply-side reforms and fiscal discipline the basis for Germany's more recent economic success (see also Mathis and Kutter 2013) and thus inevitably pushed for the same 'bitter medicine' to be prescribed to the countries struggling in the Eurozone crisis. Naturally, this approach also entailed a strong punitive component rooted in the notion of moral hazard as conservative German politicians sought to make an example of countries like Greece in order to deter future fiscal sinners (Dullien and Guérot 2012; Gocaj and Meunier 2013) rather than easing these countries' adjustment burden by expanding their own fiscal activity or even considering the mutualisation of debt.

Lastly, member states with diverging ideological affinities that would have otherwise carried enough clout to oppose the course charted by the ordo-liberal coalition under German stewardship, most importantly France, lacked the political capital to seriously push for alternative policy options. The Sarkozy-Fillon government had already given in to the austerity paradigm by 2011, mainly to preserve its "cherished AAA status" (Clift and Ryner 2014, 146). Once elected, Socialist president Hollande ultimately continued on the path of austerity despite having run on a platform to renegotiate the tightened fiscal rules of the Fiscal Compact and being critical of the austerity-heavy crisis response in Europe (BBC 2012). This was mainly due to (1) powerful political elites in the Treasury, the Banque de France, and the Budget Ministry pushing for a continuation of the 'sound money' policies charted by Sarkozy (Bezes and Le Lidec 2015), (2) an almost prophylactic response to the fears of rising bond yields with markets being traditionally more distrusting French Socialist governments (Clift and Ryner 2014), and (3) domestic and internal party opposition (Clift 2014).

Effectively, the combination of these ideological, institutional, and political factors left policy makers in EMU member states with large-scale and immediate austerity measures as the only option to tackle the intensifying sovereign debt crisis despite the fact that their procyclicality would further hamper economic growth. However, fiscal consolidation can be achieved by both cutting public expenditure and increasing tax revenues. On the basis of the above-outlined economic policy consensus that the European integration project has so far followed, it is clear that expenditure cuts would take priority over tax increases given the limited role assigned to the state in Washington-Consensus-style economic orthodoxy (Stiglitz 2008) as well as the unpopularity of tax increases among the electorate.

1.2.2 The distributive effects of fiscal consolidation measures – a review of the economic literature

Having established the political context of the austerity measures implemented in response to the Eurozone crisis, this section serves as a review of the existing economic and political economy literature on the distributive effects of such measures. In the past, research on phases of fiscal adjustment has largely focused on the determinants of success of the adjustment efforts. Much work has therefore been done in particular since the early 1990s on the effects of different variables of fiscal adjustment programmes, such as their size and composition. Most prominently, Alesina & Perotti (1995; 1996) and McDermott & Wescott (1996) show that expenditure-focused fiscal consolidation programmes, i.e. programmes that rely heavily on cutting government spending rather than increasing taxes, have a higher likelihood of success as well as being more sustainable fiscally in the long run.

The effects of such programmes on economic inequality, however, have only recently begun to climb further up on the research agenda. Studies in the past have distinguished between fiscal adjustment programmes in advanced economies, in which such programmes were implemented by national governments, and developing economies, usually as a condition for financial assistance from the IMF.

With regard to fiscal adjustment programmes in advanced economies, Agnello & Sousa (2014) analyse 18 industrialised countries from 1978 to 2009. Their study finds that periods of fiscal consolidation correlate with significant increases in income inequality. Of particular relevance to the analysis at hand is the finding that the composition of fiscal adjustment programmes is vital for their impact on income inequality: the authors show that spending cuts lead to higher levels of income inequality, while measures that focus on increasing government revenues, such as tax increases, seem to compress the income distribution. This is plausible given that spending cuts usually include cuts in social expenditure, which leads to less redistribution of market income. Increases in revenues through higher taxes, on the other hand, tend to move within an already progressive tax system, which expands its ordinarily inequality-reducing nature. A different study by Ball et al. (2013) analysing 17 OECD countries over the same period finds that both expenditure-based and revenue-based consolidation programmes have inequality-increasing effects, although the effects are more pronounced for expenditure-based measures. Woo et al. (2013) confirm this for the same sample and time period in addition to finding that, by altering the composition of the fiscal consolidation measures with regard to the progressivity of tax reforms and targeted social benefits, the inequality-increasing effects of the fiscal consolidation measures can be offset to a certain degree.

With regard to phases of fiscal adjustment in developing economies as part of a programme supervised by a supranational institution, Oberdabernig (2013) analyses the distributional effects of IMF programmes in 86 countries between 1982 and 2009. The study finds that, in the majority of cases, the programme implementation was significantly correlated with an increase in income inequality as well as poverty. However, the study includes one important qualification ascertaining that from 2000 onwards, this trend is reversed and IMF programmes between 2000 and 2009 correlate with falling levels of inequality and poverty. This coincides with the adoption of the Poverty Reduction and Growth Facility (PRGF) by the IMF, although the author stresses that the analysis does not provide a clear confirmation that the PRGF in fact caused the change in the distributive effects of IMF programmes.

Political economy accounts of how austerity measures affect inequality point in a similar direction as the economic literature in that they expect such policies to lead to higher inequality. Beyond large-n quantitative studies observing the correlation of austerity measures and income inequality, political economists add that different groups in the economy are affected differently depending on their socio-economic preconditions. Some groups are more likely to carry the burden of fiscal adjustment. Building on the work of Simmons (1994) and Gourevitch (1986), Matthijs (2016) argues that austerity measures tend to have a deflationary effect and thus disproportionately hurt debtors, whose debts increase in real value, and those relying largely on wages for their income who might "suffer either through lower nominal wages, [...] cuts in benefits, less generous government services, or higher unemployment." As these people tend to be in the lower part of the income distribution, the argument is that fiscal adjustment based on austerity increases inequality.

Another insightful account of the distributive effects of austerity in a European context provided by Matthijs (2016) comes from an application of Hacker and Pierson's *winner-take-all politics* (2010). The most important element of this line of argument is based on the notion of policy drift, which refers to institutional change brought about by leaving policies unchanged regardless of shifting circumstances, often to the benefit or detriment of certain economic actors. In the context of European austerity, this rests on the work of McNamara (1998) who has described European monetary (and by extension also fiscal) policy, characterised by favouring low-inflation policies and strict fiscal rules, as the product of an elite-based consensus built around neoliberal ideas. In the Eurozone crisis, this resulted in systematically favouring the interests of capital over labour, which further exacerbates inequality (Cioffi and Dubin 2016; Fourcade 2013; Matthijs 2016).

The literature shows that, based on past findings, increases in the levels of income inequality can be expected during and after phases of fiscal adjustment. The effect is likely to be larger in cases where fiscal adjustment is based more heavily on expenditure cuts rather than revenue-increasing measures. This is of particular importance for the analysis at hand for two reasons. Firstly, the findings imply a trade-off between the higher likelihood of success and sustainability of fiscal adjustment programmes on the one hand and progressive distributional outcomes on the other, since the former requires relying on expenditure-cuts, while the latter is jeopardised by those exact expenditure cuts. Secondly, beyond the higher likelihood of success ascribed to expenditure cuts, it is also in line with the economic policy consensus that has emerged as part of the European integration project to favour such measures over tax increases. This points to austerity measures in the European context being particularly likely to increase inequality.

1.2.3 Policy making in hard times – an alternative view to the distributive effects of fiscal consolidation measures

The accounts presented in the previous section provide a rather clear empirical case for a positive correlation of phases of fiscal consolidation and rising levels of income inequality. However, these studies hint that there can be exceptions as is demonstrated by the findings regarding IMF programmes in the post-2000 period. Specifically, it seems that the trade-off between the higher likelihood of success and the more adverse distributive effects of expenditure-based fiscal consolidation programmes can be circumvented to some degree and that inequality reductions can in fact be achieved in spite of an expenditure-based approach to fiscal consolidation if designed accordingly. The following unpacks this argument further.

To recall, fiscal consolidation can be achieved through a combination of measures that either cut public expenditure or increase tax revenues. This means that, at least theoretically, there is no reason that austerity measures necessarily cause inequality to increase: Public expenditure can be cut by lowering benefits for higher income groups such as high pension earners, cutting salaries for high-paid public sector employees, or introducing means-testing elements to e.g. childcare benefits or unemployment benefits thereby limiting higher income groups' access to such benefits. At the same time, tax increases can easily be designed in a progressive manner that shifts the tax burden towards higher income groups, particularly through higher income tax rates or increased taxes on wealth, property, assets, capital income, or inheritance. In fact, such measures may even be more likely to achieve the goal of consolidating public budgets and lowering the deficit simply because there is a greater savings potential if higher income groups are targeted (Callan et al. 2011).

This has important implications that stand in opposition to the determinism suggested by the studies cited in the previous part of this section: There is an element of choice as to how policy makers specifically design fiscal consolidation measures, which has a crucial bearing on how these measures affect the income distribution. Indeed, fiscal consolidation measures can in reality take on many shapes and forms suggesting different "varieties of austerity" (Farnsworth and Irving 2012) that go beyond the recommendations that can be deduced from the economic literature regarding the optimal composition of austerity measures and the mere balance between expenditure- and tax-based measures. With regard to the implications for the welfare state and its redistributive functions, there is in fact evidence that crises and the political realignment they bring about "are as likely to widen the scope for progressive welfare state-building as they are to diminish it" and that "how states respond is a matter of [...] political choice" (Farnsworth and Irving 2011, 278).

We know for instance that the immediate responses to the European sovereign debt crisis following the GFC were rather varied in different countries (see e.g. Schelkle 2012). Although over time, harsh and comprehensive austerity measures unsurprisingly emerged as the only option available to policy makers to cope with elevated levels of government debt (Bermeo and Pontusson 2012, 27), this rested on different conceptualisations of austerity (Bremer and McDaniel 2019; Finseraas and Vernby 2011). In other words, despite the fact that austerity appears to have been inevitable for countries facing a sovereign debt crisis, the exact design of the reform measures was not predetermined by economic necessity.

Given the wide variety of austerity measures and that their effects on the income distribution seem to depend crucially on their design, it seems inaccurate to predict that austerity programmes will have certain predetermined distributive outcomes. A survey of different planned European austerity packages conducted at the onset of the sovereign debt crisis confirms this, showing that the programmes indeed vary to the extent that their likely overall distributive effects were expected to range from largely regressive to mostly progressive depending on their design (Theodoropoulou and Watt 2011). Research building on ex-ante microsimulations point in a similar direction showing that austerity measures in different European countries can in fact have rather ambiguous distributive effects and are far from unequivocally inequality-increasing. Specifically, a number of countries implemented or announced to implement austerity measures to inequality-reducing effects by for instance raising taxes on higher incomes or restricting the access of high-income individuals and households to certain benefits while expanding them for less affluent households (Callan et al. 2011; Sutherland et al. 2013; Perez and Matsaganis 2018). The argument presented in this thesis speaks to and joins a growing body of research that is critical of the deterministic view of the distributive effects of austerity measures.

The argument that is presented here is of course not a new one. A large body of research building on Gourevitch's seminal work on *Politics in Hard Times* (1986) has sought to explain what determines policy makers' choices during times of crisis. This paper does not seek to contribute to the debate on whether it is indeed politics or rather economic necessity that dominates policy choice. Instead it focuses on the element of choice itself in proposing a counterhypothesis to the findings in the literature presented in the previous part of this section regarding the distributive effects of fiscal consolidation measures. In fact, as Gourevitch reminds us, "the moments of greatest freedom are crisis points [while] choices are more constrained in stable times" (Gourevitch 1986, 240). The impact of the choices made by policy makers in such times of crisis is thus perhaps larger or at least more obviously visible than during times of stability. These choices should therefore be at the centre of the analysis of how comprehensive economic adjustment programmes affect the income distribution: Rather than equating a particular composition of austerity measures, i.e. whether they are expenditure- or revenue-based, or even the sheer presence of fiscal consolidation measures per se with certain distributive effects, an alternative view is therefore that austerity measures have varying distributive effects depending on their exact design. The design in turn is a reflection of policy makers' aims and preferences regarding how the consolidation burden is to be shared among different income groups on the basis of which they formulate choices regarding the reform design.

1.2.4 Research question and hypotheses

The paper's central aims are to measure and explain the distributive effects of austerity measures in the Eurozone crisis. A review of the existing literature shows that there are some discrepancies between different empirical accounts: On the one hand, a number of studies have found austerity measures to be associated with increases in income inequality. Moreover, these studies show that increases in income inequality are especially large when austerity is based on cutting government expenditure rather than increasing taxes. This is explained by expenditure cuts having more detrimental impacts on the welfare state's capacity to redistribute market incomes which is of particular relevance during a recession where a larger share of the population relies on benefit payments. Conversely, tax increases are likely to move within an already progressive tax system, thus enhancing the inequality-reducing effects of such measures. On the other hand, there seem to be exceptions, such as austerity programmes administered by the IMF in the post-2000 period.

Other accounts argue that austerity, i.e. the need to consolidate public budgets, has no inherent distributive effects in one or the other direction since both expenditure cuts and tax increases can be designed in a way that they either increase or lower inequality by distributing the adjustment burden accordingly. Accepting this premise assumes that policy makers have a choice in how they design such measures and that the effects of austerity programmes on inequality depend on the aims and preferences of the policy makers involved in the adjustment process. On this basis, the paper formulates the following competing hypotheses regarding the distributive effects of austerity programmes:

$\underline{H_1}$: Austerity measures increase income inequality. The exact effects are determined by the composition of the programmes with expenditure-based programmes being more likely to increase inequality than tax-based programmes.

$\underline{H_2}$: Austerity measures have no predetermined distributive effects based on their composition. Instead, the particular design of the reform measures determine how they impact inequality, which in turn depends on how policy makers choose to distribute the adjustment burden. Policy makers' aims and preferences are thus key to understanding the distributive effects of austerity measures.

1.3 Research Design

1.3.1 Measuring inequality – a review of commonly used indicators

Many attempts have been made in the past to develop an indicator that satisfactorily measures income inequality[16]. However, as all of those indicators fall short of satisfying the entirety of the desired properties of an inequality indicator (Anand 1984; Shorrocks 1988), the indicator that emerged as the most commonly used, mostly due to its high ease of interpretation, is the Gini coefficient, which is in turn based on the Lorenz curve. This paper uses the Gini coefficient as the prime indicator for income inequality.

Visually, the Gini coefficient is calculated by dividing the area between the Lorenz curve and the 45° line of equality by the area below the line of equality, with the Lorenz curve plotting the cumulative proportions of income of the poorest x% of the population, for different values of x. The Gini coefficient therefore always takes values between 0 and 1, where 0 denotes absolute equality and 1 describing an extreme case where one person (or household, etc., depending on the measurement unit) earns all the income (Cowell 2011). In this analysis, the Gini coefficient is calculated on the basis of equivalised disposable household incomes. This is because market income, i.e. income before taxes and benefits, does not capture a state's redistributive efforts, which is the central object of analysis in this paper, and the household, rather than the individual, is the unit that redistributive policies in the tax-benefit system

[16] For more detailed discussions of various advantages and shortcomings of different inequality indicators see Anand (1983); Atkinson (1970); Foster & Sen (1997); Foster(1985); Kakwani (1980); Sen (1992; 1973); and Shorrocks (1988).

are based on. The Gini coefficient is calculated annually by aggregating monthly data.

However, while the Gini coefficient is a good measure for changes in the middle of the income distribution, it is rather insensitive towards changes at the bottom and top ends of the income distribution. The analysis based on the Gini coefficient is therefore complemented with the S80/S20 ratio, which is calculated by dividing the aggregate income of the top quintile of the income distribution by the income of the bottom quintile. The S80/S20 ratio has emerged as a commonly used addition to the Gini coefficient in measuring inequality because it is particularly sensitive towards changes at the tails of the income distribution thus cancelling out the methodological weaknesses of the Gini coefficient. Equivalent to the Gini coefficient, the calculations are based on annual equivalised disposable household incomes.

1.3.2 Presentation of the datasets

The inequality levels measured by the Gini coefficient presented here are based on microdata from the Survey of Income and Living Conditions carried out by Eurostat (EU-SILC). This dataset provides a range of social indicators, including poverty, income, social exclusion, and living conditions. The data are collected in the year after the reference period.[17] In most countries, data collection is based on household surveys, however, a small number of countries rely on a combination of administrative registers and representative interviews with household members (Iacovou, Kaminska, and Levy 2012). While it must be stated that these differences in the collection process and the sampling procedure create minor issues of comparability between different countries, it is the most accurate and comprehensive dataset that exists for the analysis of

[17] Exceptions are the UK and Ireland, where data are collected during the reference period, and 12 months after the reference period respectively.

income inequality in the EU, and is widely used in academic research. The data from the EU-SILC waves provide information on household disposable income on a monthly level, which is aggregated to an annual level, and equivalised through the 'modified OECD equivalence scale' to account for different household sizes.

The analysis in this paper is complemented by findings based on European tax-benefit microsimulation tool EUROMOD administered through the University of Essex. Microsimulation tools are frequently used by researchers to account for time lags in the data availability. They allow calculations of household incomes based on previous waves of household income survey data (EUROMOD is based on EU-SILC data) by adjusting future household incomes depending among other things on changes in the tax-benefit system. This is done by making use of additional data provided by national statistical offices and other institutions like central banks, accounting for distortionary effects, such as earnings growth (Bank of Greece 2013), tax evasion (Matsaganis, Leventi, and Flevotomou 2012), rise in unemployment (Figari et al. 2010), and non-take-up of social benefits (Matsaganis and Leventi 2014, 213). EUROMOD has been validated on both micro and macro level and tested in various applications (for further reading see Bargain 2006; Sutherland and Figari 2013). In recent years, EUROMOD analyses have found their way into the mainstream of economic policy analysis not just in academia but also in policy making cycles, as illustrated by a number of European Commission publications referred to by then-Commissioner for for Employment, Social Affairs and Inclusion, László Andor (2013).

For the context of this paper, the advantages of using tax-benefit microsimulation tools go further than filling time lag-induced gaps in the data. As EUROMOD contains all tax-benefit policies of a given EU country in a given year, it also allows to simulate the effects of hypothetical policy changes.

By changing the policies in the model and applying it to the same income data, it is possible to assess the effects that particular policy reforms such as changes in unemployment benefits or pensions have on an individual's or household's income and, by aggregating these figures, the overall income distribution in a given year. This in turn enables the use of indicators such as the Gini coefficient to capture the distributive impacts of policy measures against a counterfactual scenario that can be constructed with EUROMOD where said policy changes are absent (Duclos and Araar 2006; Reynolds and Smolensky 1977). For the scope of this paper, this is particularly valuable because it allows to exclude the effects that the recession had on income inequality through e.g. increased unemployment and thus isolate and quantify the exact distributive effects of the policy reforms.

In this context, it needs to be stated that while the analysis with EUROMOD provides useful additions to the analysis of survey data, it is restricted to 'first-order' distributive effects of policies. The concept of first-order distributive effects relates to direct effects of policy reforms on the income distribution, e.g. the direct effects of a reform in the tax-system on the different income deciles. This excludes 'second-order' distributive effects, which affect inequality indirectly through other factors such as employment. This gains importance in cases where policy reforms have sufficiently large effects to change the economic outlook of a country, e.g. if a reform in unemployment benefits affects gross incomes in such a way that aggregate demand falls sufficiently to trigger a further increase in unemployment, this will affect inequality in addition to the direct effects the reform had in the first place. However, preliminary results of studies that are working on resolving this issue indicate that second-order effects are not necessarily large enough to offset first-order effects (see e.g. Paetzold and Tiefenbacher 2018). Moreover, it is unclear that second-order effects would inevitably be unidirectional, as the reforms are ultimately aimed at sustainably expanding economic activity and would thus facilitate employment, particularly when compared to a possible scenario without reforms[18].

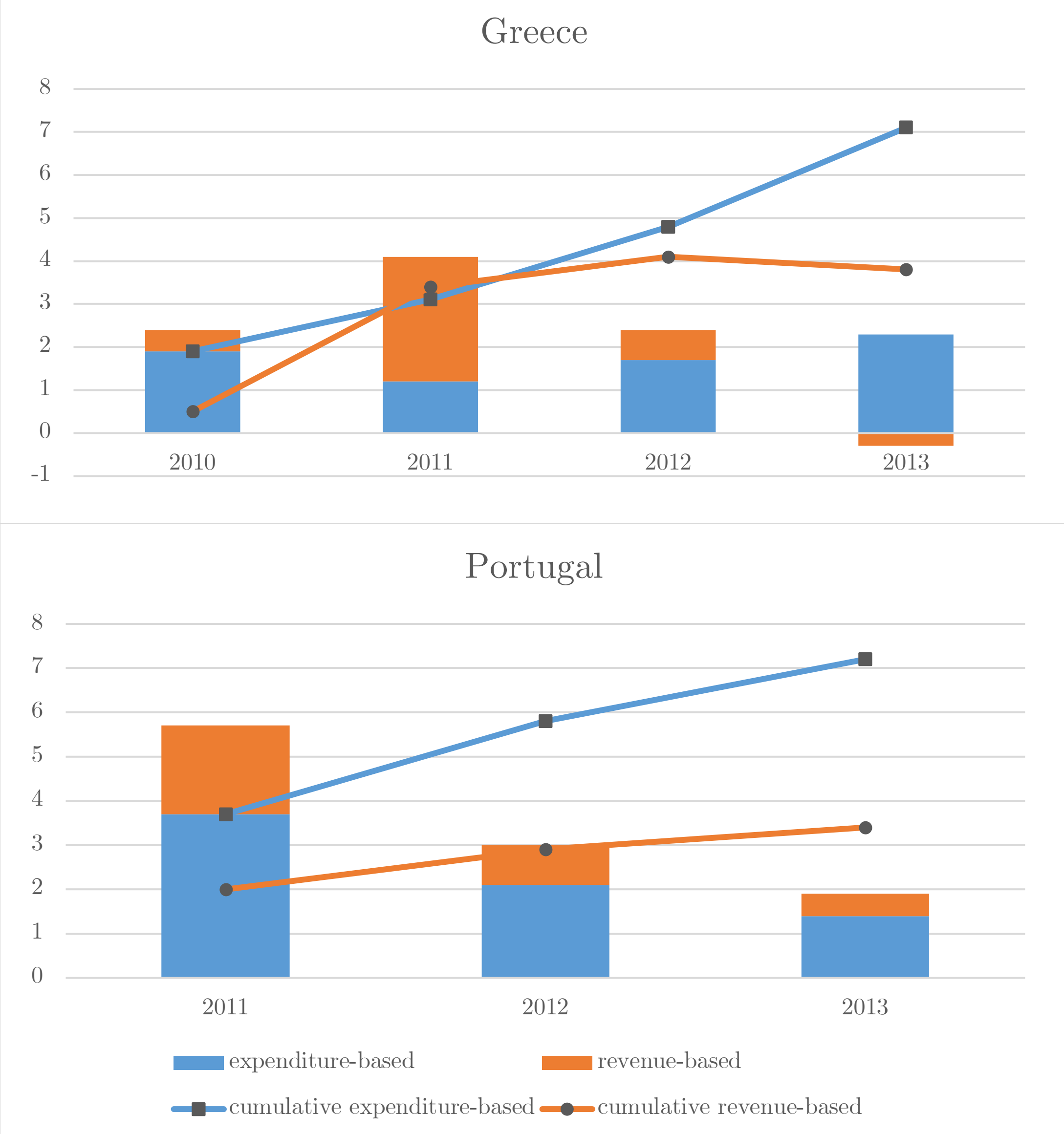
1.3.3 Case selection

Section 1.2 of this paper has shown that, on the one hand, there is a consensus in the economic literature that expenditure-based fiscal consolidation is more sustainable than revenue-based consolidation and, on the other hand, an expenditure-based approach to the consolidation efforts in the Eurozone crisis is also in line with the economic policy consensus of EU policy-makers. Consulting the Memoranda of Understanding (MoU) that preceded the EAPs yields that the policy makers of the Troika and the national authorities agreed on a course of action that strongly reflects these expectations. Outlining the planned policy reforms to achieve the intended fiscal consolidation, both the MoU of the Greek and the Portuguese programmes contain a similar focus on expenditure-based fiscal consolidation measures. In fact, both MoU stipulate that the fiscal consolidation effort would be based on expenditure cuts by a ratio of 2:1 vis-à-vis revenue-increasing measures (see Figure 3).

In that sense, based on the economic literature on the effects of expenditure-based fiscal consolidation programmes, it would be reasonable to expect similar effects of the Greek and Portuguese programmes, i.e. rising levels of inequality.

[18] For an insightful discussion of how structural reforms affect the distribution of incomes see Campos, De Grauwe, & Ji, 2017.

Figure 3: Projected austerity measures prescribed in the MoU per year, as % of GDP



Sources: Economic Adjustment Programme for Greece (European Commission 2010a), and Portugal (European Commission 2011c).

However, both in the case of Greece and Portugal, the Troika was faced with unforeseen circumstances during the implementation phase of the EAPs, which caused them to change some of the prescribed policy measures from the original MoU. In the Greek case, a much deeper recession than anticipated wiped out a quarter of the Greek economy throughout the duration of the crisis, which dried up government revenues and strained public finances much more than expected. On this basis, the targets of the fiscal consolidation effort in the first EAP were revised repeatedly and substantially, and a second programme was set up in 2012.[19] The general strategy of basing the consolidation effort largely on expenditure-based measures, however, was maintained since the beginning of the adjustment process: The Troika's response to Greece missing its fiscal targets in 2010, 2011, and 2012 was in fact to demand further efforts to close fiscal gaps in earlier years through ever deeper spending cuts. When additional revisions became necessary in subsequent years, the reform prescriptions were again corrected in scale but maintained the 2:1 expenditure-revenue-ratio.[20]

By comparison, the Portuguese programme was initially met with fewer difficulties not least due to the relatively smaller downturn of the Portuguese economy. However, while the overall budget consolidation targets were met, the implemented reforms departed substantively from the strategy outlined in the Portuguese MoU and those employed in the Greek case regarding the composition of the budget consolidation measures: Because a large part of the consolidation effort in Portugal was initially based on one-off measures, the Troika shifted their focus to ensuring more sustainable consolidation measures after 2011. In doing so, it became evident that cuts in government expenditure

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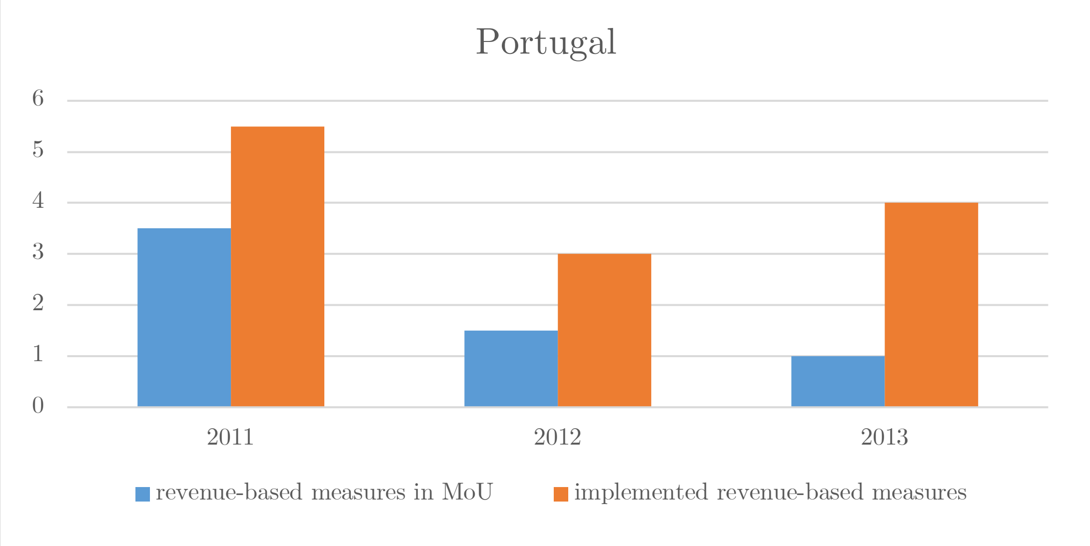
[19] It also became evident that the strategy of outlining general long-term policy prescriptions and fiscal consolidation targets was not productive amid the deterioration of the macroeconomic environment and the Troika abandoned it in favour of continuously updated medium-term fiscal strategies (MTFS).

[20] The second revision of the first EAP in December 2010 brought the first wave of additional measures that amounted to an additional 2.5% of GDP in 2011, bringing up the consolidation effort to 5.7% of GDP in that year, and an additional 5% throughout 2012-2014, two thirds of which were to be expenditure-based. In mid-2011 the Greek government adopted the first Medium-Term Fiscal Strategy (MTFS) outlining the details of the increased consolidation targets for 2012-2014. However, already later in that year, it became evident that the additional austerity measures were not enough to meet the fiscal target for 2012, resulting in heavier frontloading of those measures agreed-on in October 2011. In total, the consolidation effort in 2010 and 2011 amounted to 8.4% and 7.7% of GDP respectively, with another 5.5% planned for 2012. After the second EAP was agreed-on and the adjustment period for Greece extended by two years, the MTFS for 2013-2016 was adopted, including savings of 7.2% of GDP over 2013-2014, only 1.9% of which was revenue-based. From 2014 onwards, fiscal consolidation targets were met, and no additional consolidation measures measures were necessary.

were difficult to enforce given a number strong veto points in Portugal's political system. In particular, the Portuguese constitutional court rejected several of the reforms the Troika had pushed for (Cisotta and Gallo 2014; Moury and Standring 2017). At the same time it became apparent that revenue-increasing measures were more effective in achieving fiscal consolidation than initially assumed. This led to both the Portuguese government and with some delay the Troika officially abandoning the objective of a two thirds expenditure-based programme by 2013. The measures implemented throughout the Portuguese programme were overall much more revenue-based than both the measures envisioned in the MoU, and the measures implemented in the Greek EAPs. In fact, by the end of the Portuguese EAP, revenue-based measures were more than twice as large as initially planned in the MoU (see Figure 4).

Figure 4: Revenue-based measures in the MoU vs. actually implemented measures, per year, in billion €



Sources: Ex Post Evaluation of the Portuguese EAP (European Commission 2016)

Against this evidence, a comparative case study of the distributive effects of the Greek and the Portuguese programmes makes sense: As the literature outlined in this section suggests that expenditure-based phases of fiscal consolidation are more likely to result in increases in inequality than tax-based programmes, the Greek EAPs can be expected to result in higher levels of inequality. With regard to the specific distributive effects of a more heavily revenue-based programme such as the Portuguese, there is some disagreement in the literature on the distributive effects of revenue-based fiscal consolidation phases, which are taken to either result in lower overall levels of inequality, or smaller inequality increases than expenditure-based fiscal consolidation efforts. This suggests that the Portuguese programme would be more progressive than the Greek EAPs, although no predictions can be made regarding its precise distributive effects.

1.3.4 Methodological approach

The empirical analysis for the two case study countries is divided into three parts. In the first part, income inequality levels measured by the Gini coefficient and the S80/S20 ratio based on EU-SILC microdata are calculated for the years of the programme duration in Greece and Portugal, as well as the years preceding the crisis. This analysis is completed with a comparison of levels of inequality measured by the Gini coefficient of disposable household incomes with inequality of market incomes, i.e. incomes of households before transfers through taxes and benefits (including pensions). This exercise serves as an approximation for the redistributive capacities of the welfare state of the two case study countries.

The above-described analysis provides a comprehensive picture of how inequality as well as redistribution have developed throughout the duration of the Greek and Portuguese EAPs. However, income inequality is influenced by a variety of different factors, which is why the second part of the section provides supporting data created with EUROMOD which isolates all of these effects and assesses the direct effects of the policy reforms that were implemented as part of the EAPs. This is done by comparing income inequality levels measured by the Gini coefficient under a reform scenario and a simulated counterfactual scenario. In the reform scenario, the effects of all policy reforms that were implemented as part of the Greek and Portuguese EAPs are measured. In the counterfactual scenario, the tax-benefit systems of both Greece and Portugal are held constant from the year prior to the respective programme inception and applied to the same annual income data as the reform scenario for the duration of the EAPs. In the Greek case, the counterfactual scenario is built on the tax benefit system of 2009 (the year before the first Greek EAP began), which is applied to the available years of the programme implementation (2010 through 2017). In the Portuguese case tax-benefit policies from 2010 are applied to simulate their distributive effects in the years of the Portuguese EAP (2011 through 2014).

The third part turns to qualitative evidence in order to corroborate the quantitative findings. Based on the two competing hypotheses outlined in section 2, the distributive effects of austerity measures in the EAPs are expected to either be predetermined by their composition (H_1) or defined by the aims and preferences according to which policy makers designed the reform measures (H_2). Therefore, the third part of the empirical section scrutinises relevant policy documents such as the EAPs and the Memoranda of Understanding in which the Troika and domestic governments outline their reform proposals and targets. Moreover, the post-programme evaluation reports provided by the European Commission and the IMF are analysed. The purpose of this exercise is to identify the aims formulated by the Troika institutions regarding the desired distributive effects of the reform prescriptions. Secondary evidence such as interviews with policy makers in the Troika institutions is drawn upon to take account of the fact that the three institutions may have had diverging preferences and aims that are insufficiently reflected in their diversity through the documents related directly to the EAPs.

1.4 Empirical Analysis

1.4.1 The development of income inequality in the Eurozone

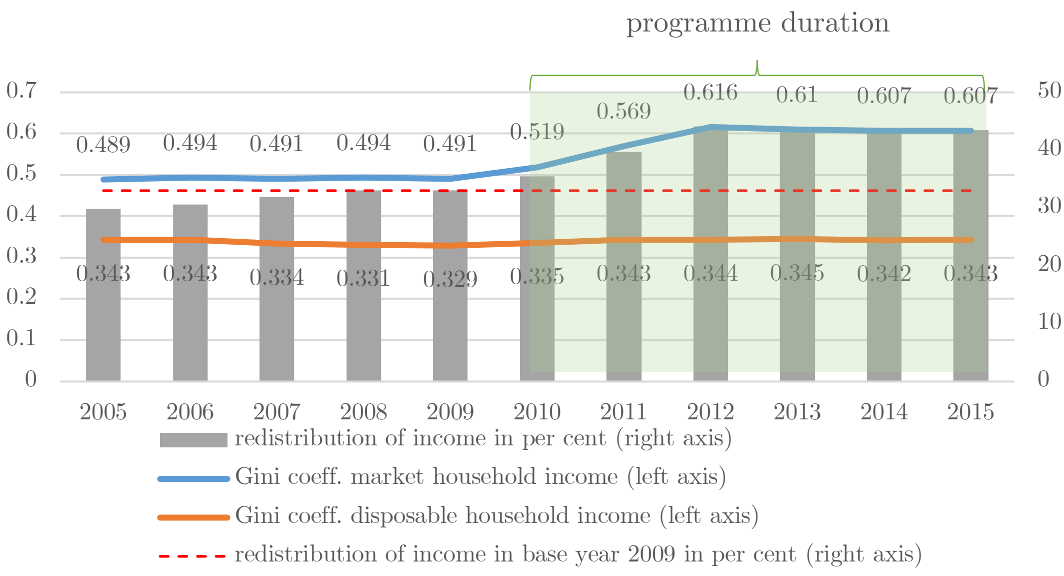
The analysis of EU-SILC data yields two major findings (see Figure 5 and Figure 6): Firstly, inequality as measured by the Gini coefficient of disposable household incomes has all but stagnated with only minor fluctuations in both countries. Some qualifications need to be made at this point: (1) in Greece, there is some increase in the Gini coefficient of disposable household income between 2010 and 2012, after which inequality remains constant for the following years. Compared to earlier years, inequality levels during the Greek EAPs stay at similar levels. (2) In Portugal, inequality of disposable household income remains constant from the beginning of the EAP onwards. However, the downward trend that inequality levels had been following in the years prior to the beginning of the EAP was interrupted. (3) The results for Greece are corroborated using the S80/S20 ratio as a second inequality indicator, which follows a similar trend. For the Portuguese case, the S80/S20 ratio shows increases in the years 2011-2013. This trend, however, began in the year 2010 and thus predated the inception of the EAP. It was only in the last year of the EAP that the S80/S20 ratio fell again. In absolute terms, the S80/S20 ratio remained below pre-2008 levels throughout the entire duration of the EAP. The changes in the S80/S20 ratio suggest that there have been changes at the tails of the income distribution that are not picked up by the Gini coefficient.

Secondly, inequality of market household incomes, i.e. household incomes before taxes and transfers, has increased substantially with the inception of the EAPs in both Greece and Portugal. While this can be attributed to the recession and rising unemployment, it is somewhat surprising in conjunction with the previous finding of stagnating levels of disposable income inequality. The widening gap between the two is illustrated in the graph by the grey bars representing the percentage difference between inequality of market and disposable household income. In the Greek case this difference has increased from 33% in the year before the EAP began (2009) to 43% from 2013 onwards. In the Portuguese case, the difference increased from 33% in 2010 to 47% by the time the programme had been concluded (2014). In other words, in both cases redistribution rose sufficiently to offset almost the entirety of the increases in market income inequality induced by the recession.

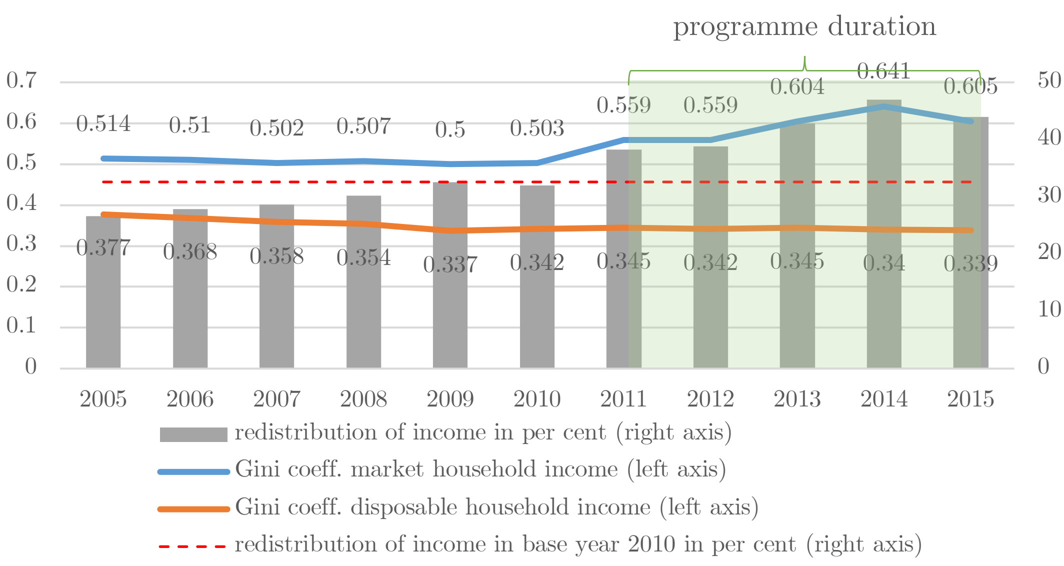
Based on these findings, it follows that the increases in inequality as expected from the review of the economic literature described in section 2 of this paper failed to materialise. This is true for both the Greek and the Portuguese case. In addition, the growing gap between market and disposable household income inequality shows that the redistributive functions of the welfare state have remained intact in both Greece and Portugal. In fact, more income has been redistributed throughout the duration of the EAPs than in the years prior to that. Moreover, considering the different composition of the Greek and Portuguese EAPs, the data show that both the strongly expenditure-based fiscal consolidation efforts in Greece, and the revenue-based consolidation in Portugal, were accompanied by remarkably similar outcomes regarding inequality of disposable household incomes and the redistribution of incomes when measured in aggregate terms.

Figure 5: Gini coefficient of disposable and market household incomes

Greece

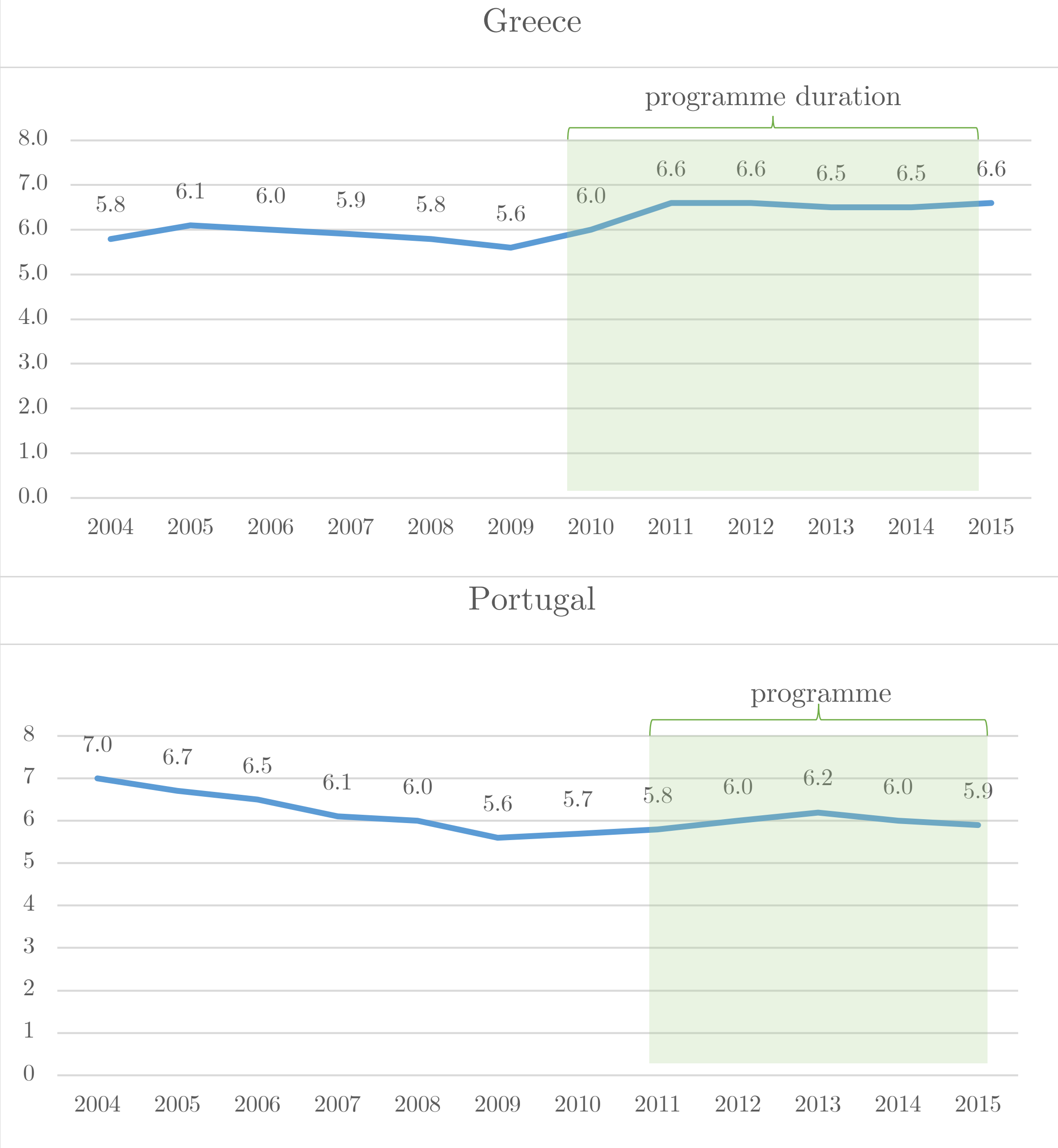


Portugal



Sources: Eurostat (EU-SILC survey [ilc_di12; ilc_di12b]).

Figure 6: S80/S20 ratio of disposable household incomes



Sources: Eurostat (EU-SILC survey).

1.4.2 Different starting points? The differences in welfare state architecture and redistributive capacities of Greece and Portugal

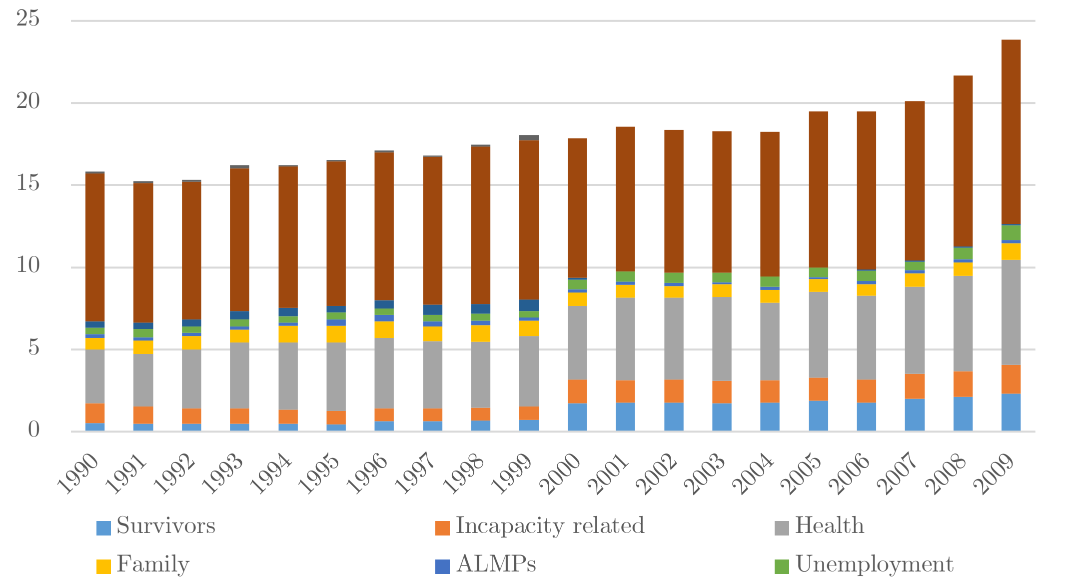
The data presented above underscore the importance of using additional techniques to measure the precise distributional impact of the reforms for reasons outlined as follows. First, the question emerges whether the Greek and Portuguese welfare states are comparable or whether they differ so starkly in their architecture and redistributive capacity that measuring the distributive effects of the reform efforts would be a moot point, if the starting points going into the adjustment process were simply too different. The vast literature on the welfare state shows that the architectures of the Greek and Portuguese welfare states, indeed, show some important differences that can be traced back to diverging modernisation trajectories of the two welfare states (Hemerijck 2013). First, however, both welfare states underwent a first expansion of social policy after democratisation, respectively the fall of the Greek military junta and establishment of the Third Hellenic Republic in 1975 and the end of the Salazar-Caetano dictatorship and subsequent adoption of the Portuguese Constitution in 1976 (Bermeo 2000; Ferrera 2010). These events resulted in a maturation of the two welfare states that strongly resembled the Continental welfare regimes in that they promoted the male breadwinner model (Gosta Esping-Andersen 1990) with only a marginal role for family benefits albeit with the important difference to their continental counterparts that old age pensions received an immense prioritisation thus constituting the distinct Southern European welfare regime (Ferrera 1996; 2005; 2010). This left more traditionally redistributive measures such as unemployment benefits and those targeted at the poor underdeveloped well into the 1980s (Matsaganis et al. 2003).

Portugal, already more advanced than Greece, and, in fact, most Southern European countries, with regard to female labour market participation experienced a further push for welfare state modernisation upon entering the EU in 1986 and through the 1990s and 2000s resulting in for instance the introduction of a minimum income scheme in 1997. In Greece similar modernisation efforts since the 1980s were met with more resistance, especially regarding the modernisation of its already then unsustainable and regressive pension system (Matsaganis 2005). Accession to the newly formed European Economic and Monetary Union in 2001 ushered in a further period of high economic growth rates. However, rather than giving welfare state modernisation a further push the convergence of Greek bond yields and easy access to credit for Greek governments led to further inertia (Spanou and Sotiropoulos 2011) leaving the country lagging behind its Southern European partners (Guillén and Petmesidou 2008).

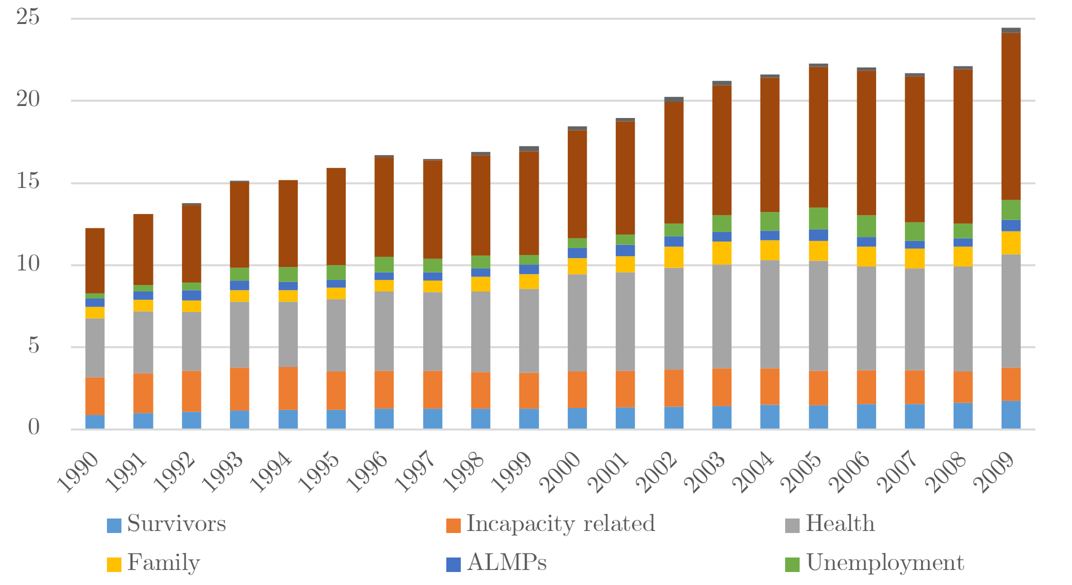
Despite these diverging historical trajectories, when comparing the spending levels on different items of social policy in Greece and Portugal, there are more similarities than differences, especially at the point of the eve of the European sovereign debt crisis in 2009. Figure 7 illustrates the following: Between 1990 and 2009, the Greek and Portuguese welfare states grew in relatively similar terms, with Greece starting at a higher absolute spending level and showing somewhat slower growth than Portugal. By 2009, the overall size of the welfare state was similar in both countries, with 23.9% of GDP in Greece and 24.5% of GDP in Portugal, although it should be noted in this context that absolute social expenditure always fluctuates, firstly as GDP grows (since we are measuring the various spending items as a percentage of GDP), and secondly with the business cycle depending on for instance unemployment and the activation of automatic stabilisers. One stark difference between the welfare states is spending on old age pensions, which was more than twice the size in Greece compared to Portugal in 1990 (9% of GDP compared to 4% of GDP). This difference shrank substantially through 2009 (11.2% of GDP in Greece compared to 10.2% of GDP in Portugal). Compared to the two largest branches, old age pensions and health, spending on for instance unemployment benefits, which tends to be more directly redistributive, is small in both countries (as is the case in virtually all mature welfare states), although smaller still in Greece. Overall, there appears to be a convergence across the different branches of the welfare state over time in both countries with spending compositions showing remarkable similarities by 2009, as is shown in Figure 8.

Figure 7: Social expenditure by branch in per cent of GDP

Greece

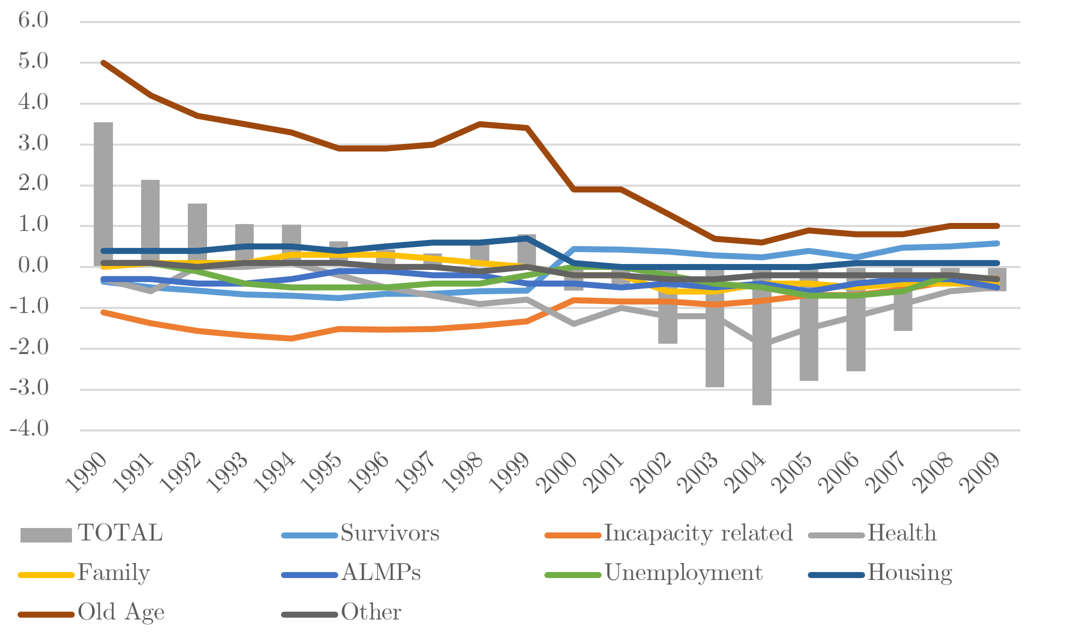


Portugal



Sources: OECD (Social Expenditure Database).

Figure 8: Differences in social expenditure by branch between Greece and Portugal in per cent of GDP



Sources: OECD (Social Expenditure Database).

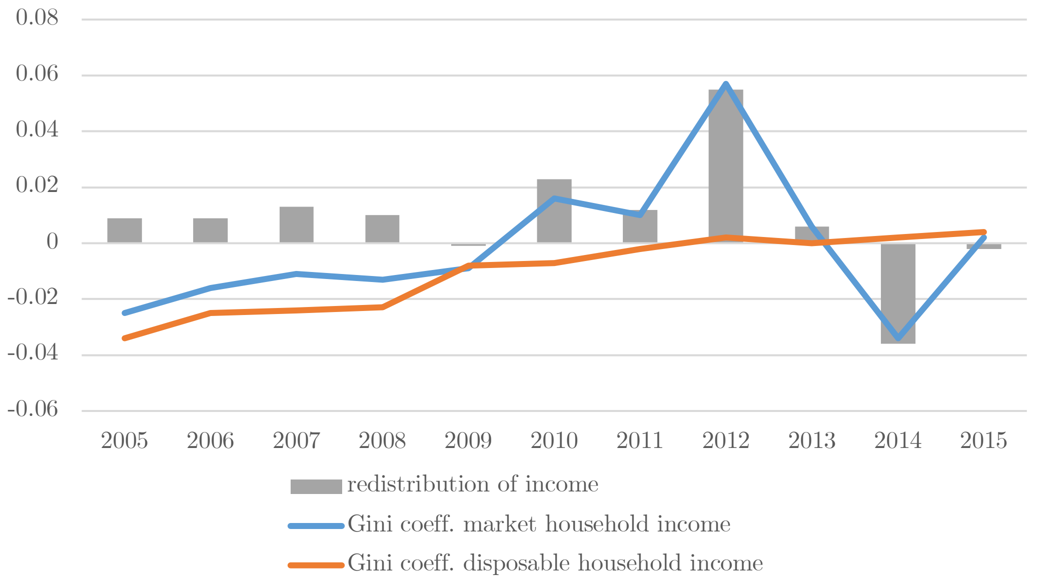
Note: Positive values indicate a higher level of expenditure in Greece compared to Portugal.

Importantly, pure spending on different branches of the welfare state says little about how redistributive the effects of the various policies under these branches are. In order to compare how redistributive the Greek and Portuguese welfare states have been, the following illustrates the differences between the two countries in the Gini coefficient of disposable and market household incomes, as well as the difference between the level of redistribution, which is obtained by comparing the differences between the Gini coefficients of market and disposable household incomes within each country. The data show the years between 2005 and 2015, i.e. the years preceding and following the GFC, as well as those of the sovereign debt crisis and the economic adjustment process.

Figure 9 illustrates that the differences in how redistributive the Greek and Portuguese welfare states have been, both before and during the economic adjustment process, are miniscule[21]. Overall, the variation in the Gini coefficient for disposable incomes ranges from 0.002 to 0.03. As the numbers for the blue and orange lines are obtained by subtracting the Gini coefficient for Portugal from the Gini coefficient for Greece in each year, negative values indicate a more equal distribution of incomes in Greece (denoted by a smaller Gini coefficient) and positive values a more equal distribution of incomes in Portugal in the respective year. The opposite is true for the numbers represented by the grey bars, which denote the differences in the degree of redistribution between the two countries: Here, the within-country difference in the Gini coefficient for market and disposable incomes in Portugal are subtracted from the difference in the two indicators for Greece. This means that negative values indicate a higher degree of redistribution in Portugal while positive values indicate a higher degree of redistribution in Greece. This shows that despite the differences in the architecture of the welfare states of Greece and Portugal, their redistributive capacities were remarkably similar. Within these very small numbers, the Greek welfare state was in fact slightly more redistributive before the onset of the economic adjustment programmes.

[21] Moreover, market incomes have also been remarkably similarly distributed in both countries since 2005 with fluctuations in 2012 and 2014.

Figure 9: Differences in redistributive capacities of the Greek and Portuguese welfare states



Sources: OECD (Social Expenditure Database).

Note: Positive values of the Gini coefficient indicate a higher level of inequality in Greece compared to Portugal. Positive values of redistribution indicate a higher level of redistribution in Greece compared to Portugal.

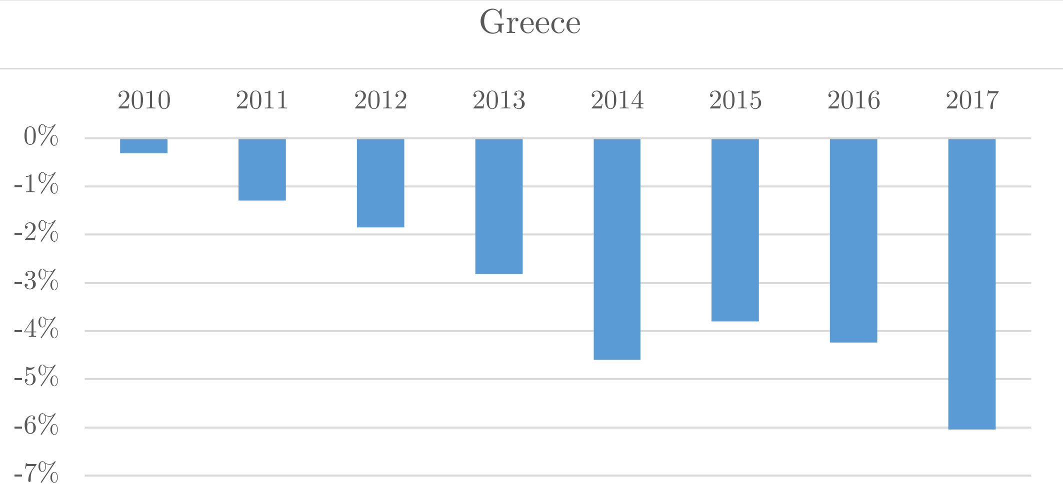
This data show that possible concerns regarding the comparability of the two cases due to different starting points regarding redistributive capacities of the welfare states going into the adjustment process cannot be substantiated. However, it is crucial that while the data presented above shows how redistributive the two welfare states were throughout the adjustment process, it is impossible to infer much regarding the distributive effects of the far-reaching reforms that were implemented as part of this process and the Economic Adjustment Programmes in the two countries in particular. This is because any such evaluation would have to account for sensible counterfactual scenarios. In other words, we would have to know whether inequality patterns would have developed differently, in whichever direction, without these reforms. This is impossible when only considering microdata for disposable incomes based on household income surveys. Moreover, it is clear that redistributive patterns always move during recessions, even without any reforms, at all, as automatic stabilisers kick in to cushion some of the increases in inequality of market incomes that are typical for recessions. Therefore, the paper turns to the next and indispensable step in the analysis using microsimulations in order to measure specifically how incomes would have been distributed in the absence of any reforms, leaving all else (e.g. increased unemployment and therefore lower incomes in parts of the population due to the recession) constant. Doing so effectively isolates the distributive effects of the reforms and allows their specific measurement.

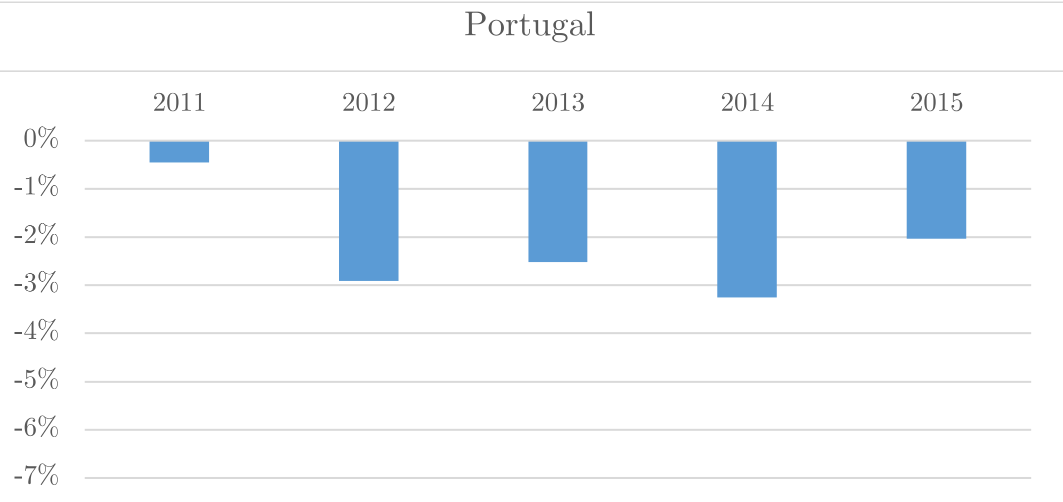
1.4.3 A microsimulation approach to assessing the distributive effects of fiscal consolidation measures

While the data presented in Figure 10 and Figure 11 give some valuable insight into the interplay between fiscal consolidation and income inequality, showing that contrary to the expectations derived from the literature inequality did not increase throughout the duration of the EAPs, these results may have been caused by a number of different factors. It is thus too early to evaluate either of the two hypotheses. The use of microsimulation allows for a more nuanced and straight-forward assessment of whether the reforms of the tax-benefit systems prescribed in the EAPs did in fact serve to alleviate market-induced increases in income inequality during the recession. To that end, this section presents a counterfactual scenario constructed with EUROMOD showing "what would have happened in the absence of the fiscal consolidation measures" (Sutherland et al. 2013, 6). In other words, the counterfactual shows how disposable income inequality would have developed, if market incomes in the various years throughout the programmes had been redistributed in each year through the same tax-benefit system that was in place in the year prior to the programme inception, i.e. before the reform efforts prescribed by the Troika began (2009 for Greece, 2010 for Portugal). Comparing the differences in the income distribution between the reform scenario (i.e. what actually happened) and the simulated counterfactual (i.e. what would have happened without the reforms), leaving market incomes unchanged in both scenarios, thus effectively allows the isolation of the exact distributive effects of the various reforms in the tax-benefit system.

This exercise yields that the reform measures in the EAPs did in fact produce lower levels of income inequality when compared to the simulated counterfactual of unchanged tax-benefit policies from before the EAPs began (see Figure 12). The reforms in the Greek EAPs produced a Gini coefficient of disposable household income of 6% below that in the counterfactual non-reform scenario by the year 2017. The reforms of the Portuguese EAP resulted in a Gini coefficient of disposable household income of between 2% and 3% below that in the counterfactual between 2012 and 2015. This confirms that the fiscal consolidation measures in the EAPs had inequality-reducing effects large enough to offset the increases in market income inequality throughout the duration of the EAPs. Moreover, the most progressive reforms were implemented as part of the Greek EAPs, which stands in opposition to the expectations formulated in H_1 that expenditure-based fiscal consolidation measures should lead to higher levels of inequality than revenue-based measures.

Figure 10: percentage difference of Gini coefficient of disposable household incomes in reform-scenario vis-à-vis counterfactual





Sources: Calculations with EUROMOD version H1.0+.

Note: Negative values indicate a lower Gini coefficient in the reform scenario compared with a counterfactual scenario without fiscal policy reforms.

In order to further elaborate on the question of how the composition of austerity measures affects the income distribution, the following provides a higher level of detail as to how exactly the reforms in the EAPs in Greece and Portugal have affected different incomes. For that purpose, this section presents data produced with EUROMOD which simulates the effects of different classes of policies on each income decile. The data show the percentage changes in income as a result of the reforms per policy class and decile. In

Figure 11 these data are presented cumulatively, i.e. as the sums of the annual percentage changes in income per decile as a result of the policy reforms. The cumulative data do not account for changes in original incomes, which the annual percentage changes refer to and therefore needs to be interpreted with some care.

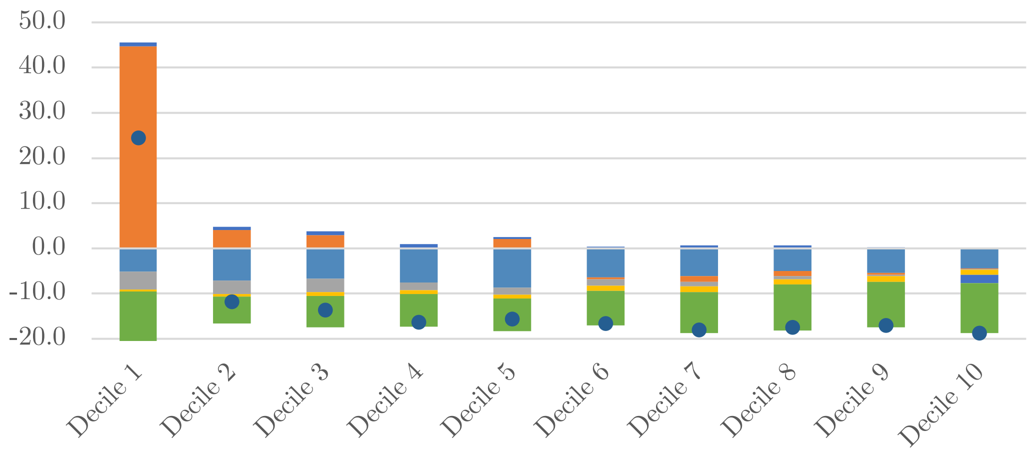
For the Greek case the findings include the following: The most progressive, i.e. inequality-reducing reform measures have been in the class of means-tested benefits. Particularly for the lowest income decile, changes in means-tested benefits led to substantive increases in disposable household income vis-à-vis the non-reform scenario. The second, third, and fifth decile saw comparatively smaller income increases through changes in means-tested benefits. Other classes of policy reforms produce mixed distributive outcomes. Changes in direct taxation produced progressive income reductions ranging from 5.9% for the second decile to 11.2% for the top decile. The lowest income decile is exempt from this trend with income reductions of 11.6% as a result of changes in direct taxation.

The analysis of the Portuguese EAP yields rather different results compared to the Greek EAPs. While changes in means-tested benefits had the largest inequality-reducing effect in the Greek case, they had the largest inequality-increasing effects in the Portuguese case. Lower income deciles saw income reductions due to changes in means-tested benefits of 15.2% (bottom decile), 4% (second decile), and 1.7% (third decile), with income reductions shrinking further for all subsequent income deciles. Changes in direct taxation on the other hand were progressive with income reductions growing from 0.3% for the bottom decile to 6.8% for the top decile.

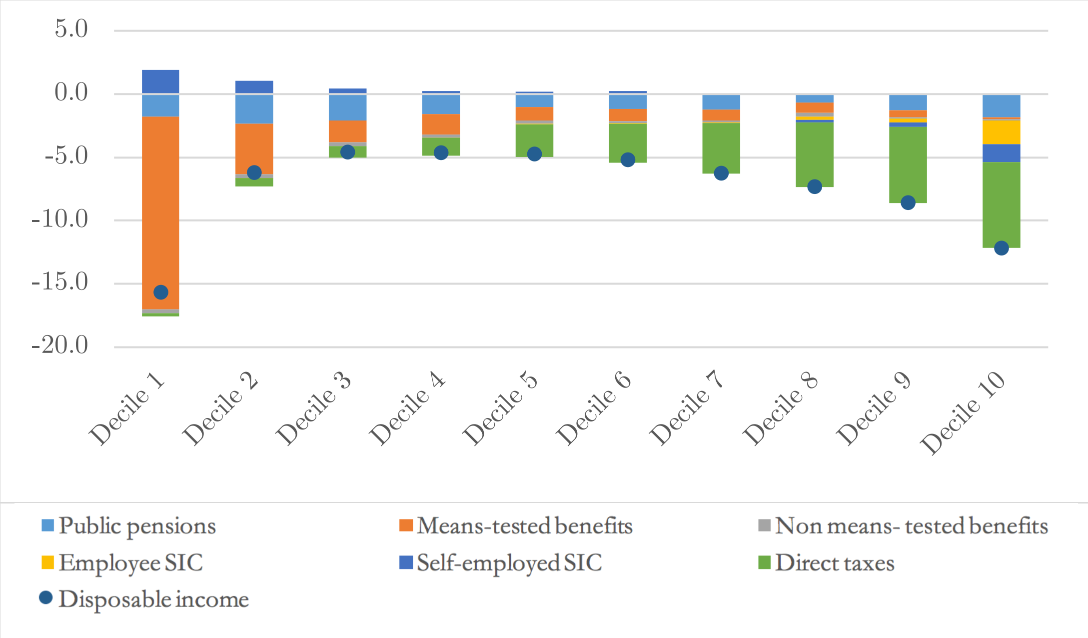
Beyond the distributive effects of the reforms by policy class, it is striking that despite the fact that both the Gini coefficient and the S80/S20 ratio show falling or at least stagnating levels of inequality throughout the Portuguese EAP, the decomposition by decile reveals the following: Middle income groups have remained somewhat shielded from the adverse effects of expenditure cuts and tax increases, resulting in an aggregate reduction of incomes for the second through to the seventh income deciles of between 4% and 6%. The eighth and ninth deciles have seen income losses of between 7% and 9% due to the reforms throughout the duration of the EAP. The biggest aggregate losses of incomes are registered for the very bottom and top deciles, with the first income decile losing 15.7% of their income throughout the EAP as a direct effect of the reforms, and the tenth decile losing 12.2%.

Figure 11: percentage change in income due to the reforms in the EAPs per decile, by policy class

Greece (cumulative effects 2009-2016)



Portugal (cumulative effects 2010-2014)



Sources: Calculations with EUROMOD version H1.0+.

Regarding the effects by policy class, it is pertinent to look at one finding from the above analysis in more detail, which is that changes in means-tested benefits had the largest inequality-reducing effects in Greece, while the opposite was the case for Portugal. For that purpose, this section compares spending levels on means-tested benefits and non-means-tested benefits in both Greece and Portugal (see Figure 12).

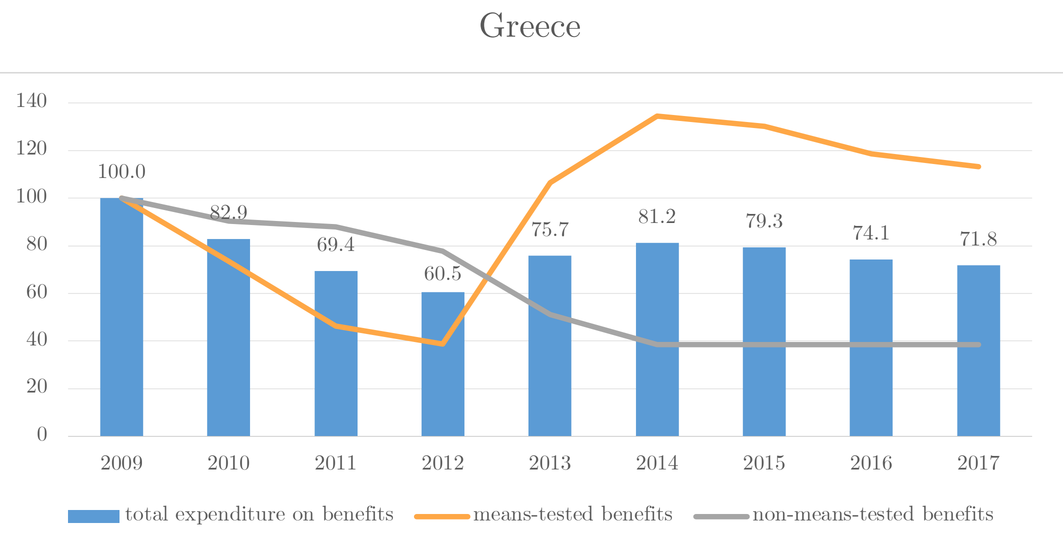
The data show that in Greece, government expenditure on means-tested benefits increased after the year 2012 to levels above those of 2009. Considering that the indexation refers to absolute expenditure levels and that in the same period the Greek economy shrank substantially, this signifies a large increase in government expenditure on means-tested benefits as a share of GDP. The increases in spending on means-tested benefits coincide with inequality-reducing effects that changes in means-tested benefits had on the income distribution measured with EUROMOD. At the same time, spending on non-means-tested benefits decreased to almost one third of 2009 levels from 2014 onwards.

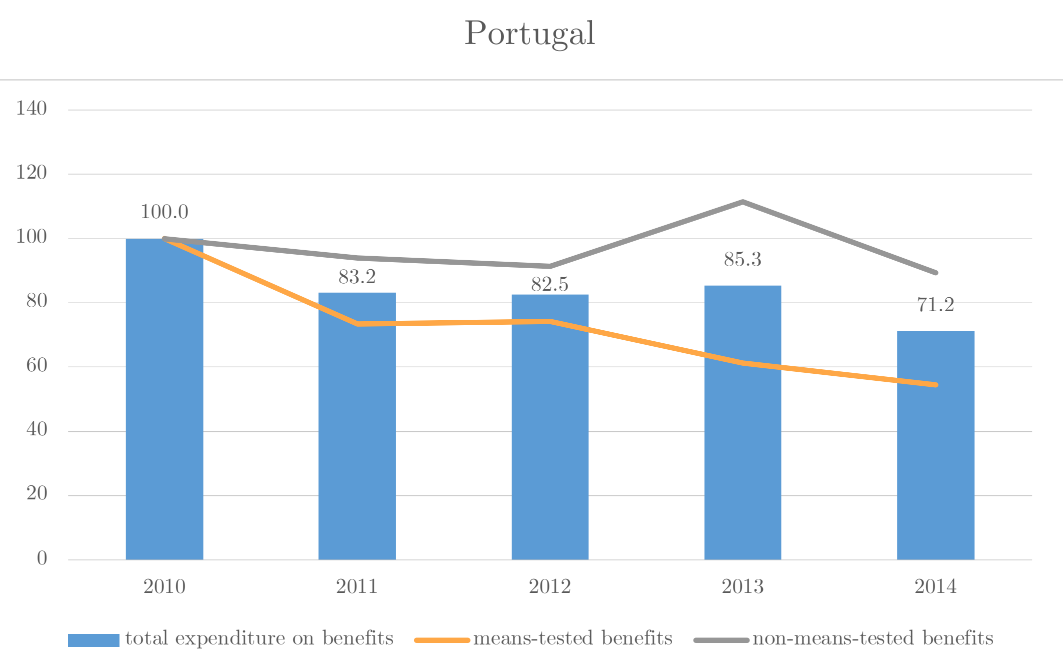
By comparison, spending on means-tested benefits in Portugal dropped to almost half of the 2010 spending level by the end of the EAP, whereas spending on non-means-tested benefits fluctuated between 10% below and above 2010 spending levels. This suggests that the inequality-increasing effect of changes in means-tested benefits in Portugal stems from a simple reduction in government spending on means-tested benefits, the opposite of which was the case in Greece, where spending was shifted from non-means-tested to means-tested benefits.

More generally, these results call into question the notion that the mere composition of austerity measures, i.e. whether they are based on expenditure-cuts or tax hikes, has a substantive bearing on their distributive effects: Throughout the adjustment programmes in both Greece and Portugal, total spending on non-pension benefits fell to similar levels at 71.8% of the base year (Greece) and 71.2% (Portugal) respectively. However, benefit reforms were progressive in Greece and regressive in Portugal due to the expansion of means-tested and cuts in non-means-tested benefits in Greece, while most of the expenditure cuts in this policy class in Portugal came solely from means-tested benefits.

Figure 12: Government expenditure on means-tested and non-means-tested benefits (excluding pensions)

Index (Greece: 2009=100; Portugal: 2010=100)





Sources: Calculations with EUROMOD version H1.0+.

These results suggest that the austerity measures that were part of the EAPs were, in fact, progressive. On this basis, H_1, which rests on the notion of a deterministic relationship between austerity measures – and in particular expenditure-based measures – and rising levels of income inequality, must be rejected. Moreover, the data presented here suggest that the composition of austerity measures, i.e. whether the consolidation effort is to be achieved by cutting government spending or by raising taxes, seems to be of secondary importance for their distributive effects: The heavily expenditure-based Greek programmes were found to be more progressive than the more revenue-based programmes of Portugal. Rather than their composition, it seems to be the exact design of the reforms that is crucial for their distributive effects. This is exemplified particularly by the distributive effects by policy class calculated with EUROMOD: Spending cuts on benefits in Portugal had inequality-increasing effects, while in Greece the opposite was achieved by shifting spending from non-means-tested to means-tested benefits while overall reducing spending on non-pension benefits.

1.4.4 Limitations of the analysis and how to address them

1.4.4.a On the merits and shortcomings of microsimulation approaches

At this point it is important to note that microsimulation approaches to measuring the distributive effects of policy reforms inevitably have limitations. The following section serves to outline these limitations as well as argue why they represent necessary trade-offs of the analysis. Closely connected to the limitations of the microsimulation approach are certain limitations regarding the way in which inequality is measured and the conclusions that such measures yield for the wider assessment of the respective policy reforms' impact. First, microsimulation serves to close a gap left by analysing inequality based on household- and individual-level microdata. Drawing on such data to infer the effects of certain policy reforms on the income distribution is insufficient in that it is confounded by various variables such as the wider economic situation. This can be illustrated easily when considering cases of deep economic recessions – much like those that are the object of study in this thesis – and the way in which they impact inequality: If significant parts of the working population lose their jobs due to an economic shock, this inevitably produces changes in levels of inequality. The exact ways in which this manifests depend a number of factors including the respective economy's welfare state and various buffer policies such as unemployment benefits (Atkinson 2009), as well as the nature of the economic shock in affecting individuals across the board or only those in certain sectors and income groups. Similarly, the unit of analysis significantly affects the results produced when measuring income inequality during an economic downturn as for instance women and men may be affected in different ways, which in turn substantially affects incomes by household when compared to individual incomes (Bettio et al. 2012). Importantly, these dynamics can move in opposing directions so that it is technically unclear in what ways exactly recessions affect inequality (Jenkins et al. 2013), although in many cases they go hand in hand with rising levels of inequality through the channel of increased unemployment (Nolan 2009).

Microsimulation tools allow to overcome this deficiency by excluding from the analysis the effects of the recession. In its essence, analyses based on microsimulations do not ask the question 'what was' but 'what would have been' in the absence of certain reforms, which then allows the estimation of the reform effects as the difference between the two scenarios (Sutherland and Figari 2013). In using such tools, the thesis speaks to and joins a growing group of scholars employing microsimulations to estimate precisely the distributive effects of different types of reforms (see e.g. De Agostini et al. 2014 and the over 500 contributions to the EUROMOD working paper series). However, it is also clear that in its focus on measuring the distributive effects of tax-benefit policies, such tools do not ordinarily include policies that affect the original incomes used to compute inequality indicators in the microsimulation process, i.e. those policies that are commonly labelled as pre-distributive, which includes for instance changes in public sector wages. Similarly, while microsimulation tools expressly incorporate the effects of direct taxation on household or individual incomes, it leaves out the distributive effects of indirect taxation, such as value-added tax, which often constitutes significant parts of reform packages.

1.4.4.b The distributive effects of public sector wage cuts and changes in indirect taxation

Both policies affecting original incomes, and changes in indirect taxation have been addressed by scholars working with microsimulation. Pre-distributive policies, such as public sector wage cuts, have been taken into account in these studies by incorporating information on individuals' employment and changing the original income of those individuals in the sample by the respective wage cuts based on their previous incomes and the specific reforms implemented. With regard to the specific cases of the Economic Adjustment Programmes in Greece and Portugal, public sector wage cuts played a significant role in the overall adjustment process, making it indispensable to at least estimate the distributive effects of these measures. The following provides an overview of the prescribed measures regarding public sector pay cuts for Greece and Portugal (see Table 2 and Table 3).

Next to an overall reduction of the number of public sector employees, the various reform measures entailed a reduction of public sector wages, including those in state-owned enterprises, mainly through the elimination of additional monthly holiday payments (in the case of both Greece and Portugal), as well as more detailed measures including direct wage reductions with a progressive ratio, reducing allowances for ministerial staff, and the gradual elimination of exemptions made from newly introduced pay structures throughout the reform process (in the case of Greece). In this context it is vital to point out that the agreed-upon and implemented reforms in Portugal were later declared unconstitutional by the Portuguese Constitutional Court and had to be reversed almost fully at the end of the EAP (this is addressed in Paper 2 of the thesis together with a case study of the Portuguese pension reform, which was also struck down by the Court).

Table 2: Public sector pay cuts as prescribed in the MoU and reform plans presented to the Troika in Greece outlined in EAP documents

Stage	Reform
1st EAP/MoU (European Commission 2010a)	Prescription: • "[One of t]he three biggest upfront measures are an immediate cut in the public sector wage bill" (p. 47) • "launch a process to create a simplified remuneration system to cover basic wages and all allowances applying to all public sector employees and ensuring that remuneration reflects productivity and tasks" (p. 83)
Fourth review (Dec 2011) (European Commission 2011b)	Agreed-upon reforms: • "Cuts in wage bill by at least EUR 770 million in 2011, and additional EUR 600 million in 2012, EUR 448 million in 2013, EUR 306 million in 2014 and EUR 71 million in 2015, through the implementation of attrition beyond the rule of 1 recruitment for 5 exits (1 for 10 in 2011); an increase in weekly working hours for public sector employees from 37.5 to 40 hours and reduction in overtime payments; reduction in the number of remunerated committees and councils; reduction in other additional compensation, allowances and bonus schemes; reduction in contractors (50 percent in 2011 and additional 10 percent in 2012 and onwards); temporary freeze of automatic progression; the implementation of a new remuneration grid; the introduction of part-time public sector employment and unpaid leave; a reduction in the number of admissions to military and policy academies, the transfer of excess staff to a labour reserve paid on average at 60 percent of their wage (excluding overtime and other extra payments) up to 12 months, and a cut in the productivity allowance by 50 percent." (p. 140) • "Adjustments in public employee compensation (0.6 percent of GDP). A new wage structure will be introduced by mid-August and phased in over 3 years. It will bring wages into line with private sector norms (achieving "equal pay for equal work") and decompress the wage structure to better reward performance. Overall savings will be achieved by eliminating special wage regimes and allowances, and reducing automatic wage drift. Wages of state-owned enterprises employees will

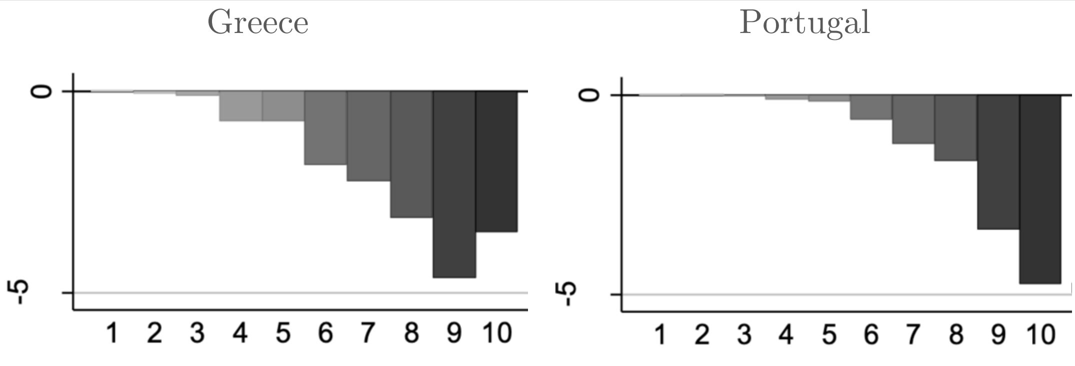
	be in line with the new wage grid for the public sector." (p. 86)
2nd EAP/MoU (European Commission 2012a)	Prescription: • "adjust the wage grid for special regimes effective July 1, 2012 (including for judges, diplomats, doctors, professors, police and armed forces), while protecting those at lower pay scales, to realize permanent net savings of about 0.2 percent of GDP on an annual basis." (p. 97) [went into effect August 1, 2012 (European Commission 2012b)]
First Review (European Commission 2012b)	Agreed-upon reforms: • "Adopt legislation to effectively reduce monthly wages of employees under special wage regimes (excluding Christmas, Easter and summer bonuses), effective August 1, 2012, with the following marginal reduction schedule: 2 percent for wages below €1000; 10 percent for €1000–1500; 20percent for €1500–2500; 30 percent for €2500–4000; and 35 percent for wages above €4000. • Adopt legislation to reduce the State wage bill by €56 million in 2013 and additional €27 million in 2014, including by further reducing fixed–term hires by 10 percent relative to the baseline (€38million in 2013, €25 million in 2014), rationalizing the allowances of Members of Parliament, and their staff (€2 million in 2013), reducing the wage bill for consultant doctors (by €11 million in 2013), and introducing a hiring freeze at the Ministry of Citizen Protection. • Adopt legislation to introduce a new wage grid for parliamentary staff, yielding savings of €14million in 2013. • Adopt legislation to eliminate the public sector seasonal bonuses of employees at the state and local governments, and at legal entities of public and private law, to produce savings of €431 million in 2013. • Adopt legislation to abolish all exemptions from the public sector wage grid reform introduced in 2011, excluding HFSF and HRADF, with savings of €8 million in 2013. • Adopt legislation to suspend, through 2016, the fiscal bonus of public sector employees, saving €78million in 2013. • Adopt legislation to suspend, through 2016, the performance bonus of public sector employees, saving €214 million in 2013. • Adopt legislation to reduce the local government wage bill with savings of €50 million (to take effect in January 2013). • Adopt legislation to align the wage grid for all state-owned enterprises in Chapter A Entities of Private law with the new wage grid for state employees, effective January 1, 2013. • Repeal the provision that provides a full pension to government employees with 20 years of service in case of layoff without losing their social security contributions." (pp. 180f.)

Table 3: Public sector pay cuts as prescribed in the MoU and reform plans presented to the Troika in Portugal outlined in EAP documents	
Stage	Reform
EAP/MoU (European Commission 2011c)	Prescription: • "Wage cuts in the public sector are expected to contribute to wage moderation in the private sector" (p. 17) • "Ensure that the aggregate public sector wage bill as a share of GDP decreases in 2012 and 2013 • Limit staff admissions in public administration to achieve annual decreases in 2012-2014 of 1% per year in the staff of central administration and 2% in local and regional administration • Freeze wages in the government sector in nominal terms in 2012 and 2013 and constrain promotions • Reduce the overall budgetary cost of health benefits schemes for government employees schemes (ADSE, ADM and SAD) lowering the employer's contribution and adjusting the scope of health benefits, with savings of EUR 100 million in 2012" (p. 60) Action to be completed by domestic government (by Q2-2012): • "Prepare the plan ensuring that the aggregate public sector wage bill as a share of GDP decreases in 2012 and 2013" (p. 109)
Second review (Dec 2011) (European Commission 2011d)	Plan: • "The 2012 budget targets a general government deficit of 4.5 per cent of GDP, in line with the Programme. To this effect, it contains bold consolidation measures, totalling 6 per cent of GDP, of which two thirds are on the expenditure side. Key measures include significant nominal cuts in public sector wages" Agreed-upon reforms: • "Ensure that the public sector wage bill decreases in gross terms in 2012 by at least EUR 3,000 million (EUR 1,620 million taking into account the losses of government revenues at the level of income taxes and social contributions); • reduce wages for all general government sector employees in 2012 by (i) suspending the 13th and 14th monthly salary payments for those workers with monthly salaries of EUR 1,000 or more, (ii) suspending on average and in a progressive way the equivalent of one of those two salaries for those

	workers with monthly salaries between the minimum wage of EUR 485 and EUR 1,000. Similar measures will apply to all SOEs classified inside and outside the perimeter of the government sector, and in any other public entity even if falling outside the perimeter of the government sector; • reduce the number of government employees by (i) limiting staff admissions in order to achieve annual decreases of 2% (full-time equivalent) in 2012-2014 in the permanent staff of central, regional and local governments, (ii) decreasing the number of temporary positions in specific areas of public administration. To support these objectives, binding numeric targets for staff reductions per main area of the administration will be defined by December 2011; • suspend all promotions in 2012; • reduce the overall budgetary cost of health benefits schemes for government employees schemes; • savings from the public administration restructuring." (p. 86)

The distributive effects of public sector pay cuts have been studied extensively. The various results presented in the literature suggest that public sector pay cuts, rather than changing the findings regarding the progressivity of austerity measures presented in this thesis, serve to reinforce them. Sutherland et al. (2013) find that between the Global Financial Crisis and 2013, which covers the First EAP and parts of the Second EAP for Greece and significant parts of the EAP for Portugal, public sector pay cuts in Greece and Portugal have had overwhelmingly progressive effects (see Figure 13). The findings are confirmed by Matsaganis and Leventi in a study on the distributive effects of the reforms in Greece, focusing specifically on public sector pay cuts (2014). This makes sense given that the overall reductions in public sector wages were most severe for higher incomes, as well as the fact that public sector employees tend to be situated in the top half of the income distribution in any case. Similar findings have been presented for public sector wage cuts in other countries under Troika surveillance, most notably Ireland (Callan, Nolan, and Walsh 2011).

Figure 13: Distributive effects of public sector pay cuts in Greece and Portugal, in per cent, by decile, 2008-2013



Source: Taken from Sutherland et al. 2013.

Similar to public sector wage cuts, increases in indirect taxation, most notably VAT, were a cornerstone of the adjustment processes in both countries. In Greece, VAT rates were increased between 2010 and 2011 from 19% to 23% (standard rate), from 9% to 11% (reduced rate), and from 4.5% to 5.5% (base rate). This was followed by a further increase to 24% for the standard rate in 2016. Increase in VAT rates were accompanied by increases in other excises for fuel, tobacco, alcohol and other products. Importantly, a number of exemptions were made as part of the EAPs, such as for instance a reduction of the VAT rate for drugs from the reduced to the base rate. Initial considerations to move more goods and services that were subject to the reduced rate to the standard rate were abandoned in favour of increasing the reduced rate. Overall, the envisioned savings were among the most significant of the adjustment process with VAT rate increases accounting for planned fiscal savings of €1.8 billion per year (European Commission 2010b, 54). In Portugal VAT rates were increased from 21% to 23% (standard rate) in 2011 while base and reduced rates remained unchanged. In this context it is important to note VAT increases were an immensely common policy measure across the EU, and a number of member states increased their VAT rates as part of their fiscal consolidation efforts in the post-GFC era, including Bulgaria (in 2011), Czech

Republic (four times between 2010 and 2015), Spain (in 2010 and 2012), France (in 2012 and 2014), Croatia (in 2013 and 2014), Italy (three times between 2011 and 2016), Latvia (four times between 2009 and 2018), Luxembourg (in 2015), Hungary (in 2012), Malta (in 2011), the Netherlands (in 2012 and 2019), Austria (in 2016), Poland (in 2011), Slovenia (in 2013), Slovakia (in 2010 and 2011), and Finland (in 2010 and 2013) (European Commission 2020). In the same vein, the Greek government had already initiated VAT rate increases prior to the entry of the Troika, as had the Portuguese government. Overall, this calls into question whether the Troika imposed VAT increases onto the governments of the EAP countries entirely against their will. Nevertheless, the Troika expressly welcomed these measures, and in the Greek case made further VAT increases part of subsequent EAPs (European Commission 2010a, 13).

VAT increases are widely accepted to be regressive because they disproportionately affect lower-income households that spend a larger share of their incomes on consumption, and in doing so often draw on past savings or take on debt (Matsaganis and Leventi 2014). The same is true for other indirect taxes such as excises on fuel, which were also a large part of the adjustment programmes. The detrimental effect of increases in excises on heating oil, which a large number of people especially in Greece depend on, is only one example of many to underscore this point and is particularly salient for low-income families who then turned to burning wood they found in the cities in order to heat their homes in the winter (Daley 2013).

Measuring the precise effects of VAT hikes through microsimulation measures is a complex exercise that requires data on household consumption patterns. Recently, efforts have been made to incorporate changes in indirect taxation into microsimulation tool EUROMOD, although the tool is still in the testing phase and no comprehensive analysis has been undertaken to date (De Agostini et al. 2017). With regard to the findings presented earlier in this paper, it is possible to make the following inferences regarding the distributive effects of VAT hikes: (1) Overall, the distributive effect is undoubtedly regressive, although some efforts have been made to exclude certain non-luxury and essential products from VAT hikes in the EAPs; (2) with regard to the effects observed in Greece, this would certainly weaken the progressivity of the other measures. However, given the fact that especially the bottom decile received large relative increases in income (despite absolute losses due to the depth of the recession), it is doubtful whether VAT hikes would offset this trend completely; (3) with regard to the observed distributive effects of the reforms in Portugal, VAT hikes are also likely to have a distinctively regressive effect, although given the smaller magnitude of the increases, less so than in Greece. Overall, this would shift the inverted U-shaped curve observed in Figure 11 to the right. Further analysis would be necessary to see in how far this actually strengthens the observed trend of austerity being largely protective of middle-income groups in Portugal given that excluding changes in indirect taxation the most protected groups are situated somewhat to the left of the middle of the income distribution. Incorporating the effects of VAT hikes could thus shift the most protected groups further to the middle.

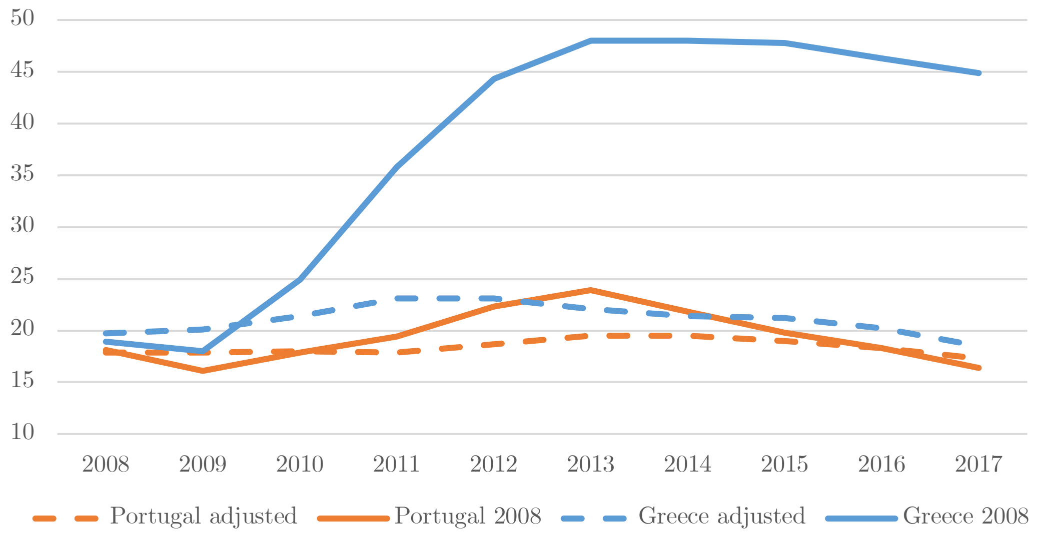
1.4.4.c The effects of austerity measures on poverty

A further important limitation of the analysis presented here is related to the issues of absolute income levels, as well as relative poverty levels. However, this has less to do with the shortcomings of microsimulation tools themselves but with methodological weaknesses of inequality measures. While most of the scholarly literature takes income inequality to be based on relative differences of disposable household incomes, the case of Greece provides an excellent example of why this is problematic in multiple ways. Firstly, relative measures of inequality by definition ignore absolute levels of income. Despite this being a patently obvious point, the ramifications are immense for the case at hand.

To illustrate this, throughout the crisis, the Greek economy contracted by around 25%; naturally disposable incomes fell significantly during this period: Between 2010 and 2015 median equivalised disposable income fell from just below €12,000 p.a. to just over €7,500, while prices during the same time stayed at more or less the same level with only slight deflationary tendencies. Therefore, the observed losses in nominal incomes translated into massive income losses in real terms (Eurostat 2019b).

To further illustrate this, the below shows at-risk-of-poverty rates for both Greece and Portugal throughout the crisis with an annually readjusted at-risk-of-poverty threshold (60% of median income) and fixed poverty threshold from 2008 (see Figure 14). While the numbers show a slight difference for Portugal, the divergence between the anchored and readjusted at-risk-of-poverty rates for Greece are stark: When the poverty threshold is adjusted in each year, the share of people living on less than that threshold rises from just over 20% in 2009 to just over 23% at its peak in 2012. With the poverty threshold fixed at the absolute level of 2008, the share of people who are at risk of poverty rises from 18% in 2009 to 48% in 2013 and fell only slightly below that in the following years. In other words, from 2013 onwards, almost half of the Greek population had an income with which they would have counted as being at risk of poverty in 2008. In the face of largely unchanged price levels, this signifies substantial material deprivation for a large part of the Greek population.

Figure 14: At-risk-of-poverty rates with annually readjusted and 2008-fixed poverty threshold in Greece and Portugal



Type/ Year	'09	'10	'11	'12	'13	'14	'15	'16	'17
PT ADJ.	17.9	18.0	17.9	18.7	19.5	19.5	19.0	18.3	17.3
PT 2008	16.1	17.9	19.4	22.3	23.9	21.8	19.8	18.3	16.4
EL ADJ.	20.1	21.4	23.1	23.1	22.1	21.4	21.2	20.2	18.5
EL 2008	18.0	24.9	35.8	44.3	48.0	48.0	47.8	46.3	44.9

Sources: Eurostat (EU-SILC survey [ilc_li02; ilc_li22b]).

This showcases that, while relative income inequality may have gone down in Greece, there was 'progressive impoverishment' when incomes in absolute terms are considered. Of course, the vast drop in incomes in Greece was not a direct result of the reforms but of the recession and ensuing unemployment (although doubtlessly the procyclical reforms are likely to have worsened the recession). Nevertheless, considering absolute income levels is crucially important, particularly when evaluating the success of certain policies with regard to their distributive effects. On the other hand, these numbers should not call into question entirely the findings regarding the progressive distributive effects of the reforms; once the Greek economy recovers and incomes reach pre-crisis levels, by virtue of the reforms in the tax-benefit system, disposable incomes will be distributed more equally at a higher level.

It is important to disentangle at this point the effects of the implemented austerity measures on poverty from those of the wider recession. On the one hand, the increase in poverty is largely due to the dramatic rise in unemployment in Greece. On the other hand, even as employment has slowly picked up again in recent years, at-risk-of-poverty rates with anchored poverty thresholds remained at high levels through 2017, which suggests that disposable incomes in the bottom half of the income distribution have not recovered in absolute terms. While the findings presented in this paper suggest that poverty rates should decrease due to the more progressive tax-benefit system now in place once pre-fisc incomes recover from the crisis, the important question remains whether austerity measures have contributed to the prolonged depression of incomes. Based on the findings regarding the underestimation of fiscal multipliers presented by Blanchard and Leigh (2013), the answer to this question must clearly be affirmative: Austerity measures did, in fact, deepen the recession and by extension pushed more people below the poverty line. However, as Matsaganis and Leventi in their analysis of the effects of the Greek crisis on poverty note, a crucial – and unanswerable – question in this context concerns the relevant counterfactual: Given the fact that the Greek crisis had deep structural components centred around for instance the diminishing competitiveness of Greek firms in the years preceding the crisis, it is difficult to assess how deep and how long the recession would have been in the absence of the austerity measures.

This paper remains agnostic as to the exact nature of this counterfactual and its implication for the depth of the crisis. However, relating back to the presentation of the political determinants of austerity measures in the EU in the introduction to this thesis, it is also clear that the severity of the austerity measures in the Eurozone periphery, including in Greece, could have been softened somewhat by an expansion of fiscal activity by member states in the core of the Eurozone. By the logic presented above, this would have certainly alleviated some of the increases in poverty thus calling into question an entirely structural explanation of the causes of the dramatic increases in poverty rates in Greece. Conversely, however, it is also clear from the findings presented in this paper that a less progressive design of the changes in the tax-benefit system, as one part of the austerity measures, would have resulted in an even further increase of poverty rates. In this regard the findings presented are consistent with the analysis of other authors (Matsaganis and Leventi 2014; Sutherland et al. 2013).

1.4.4.d The importance of public goods and services

A similar limitation of the commonly used inequality measures relates to the notion of disposable income. While accounting for post-fisc changes in income pertaining to e.g. taxes or benefit payments, the notion of disposable income still fails to capture important elements of household expenses that are related to the welfare state in a broader sense. For instance, universal health care saves households large expenditures which would otherwise be incurred regularly. Similarly, publicly provided transport systems, education, or housing all have an immense impact on household finances but are not captured by their disposable income. In other words, if country 'A' provides the above-listed goods and services to its citizens, and an otherwise identical country 'B' does not, disposable household incomes would ceteris paribus be the same in both countries. However, households in country 'A' would be "richer", in that they would clearly be able to spend more on non-essential items.

Future research should address this limitation of the notion of disposable income as a measurement of households' real income. This would also have important ramifications for the research of inequality and redistribution, and welfare state retrenchment: if the provision of public goods and services in one country is cut substantially, this would have substantial impacts on households' real incomes and should thus be incorporated appropriately in our measures of income and inequality. Again, Greece is a case in point here: One result of the deep cuts in public budgets was that public health needs remained unmet over the last years, to a point where the public health system was pushed to a breaking point ("In the name of tough fiscal targets, people who might otherwise survive are dying" (Smith 2017); see also Economou et al. 2014; Simou and Koutsogeorgou 2014; Zavras et al. 2016). Some progress has already been made in the direction of improving measures of income and inequality in this regard (see e.g. Vaalavuo 2011; Verbist, Förster, and Vaalavuo 2012), although a systematic analysis of different welfare regimes and redistributive patterns with these tools would be warranted.

Overall, this section illustrates that the findings presented in this paper, while surprising, are not wholly positive: Less severe austerity measures, would have likely resulted in less adverse effects on poverty. This would have, however, required cooperation from the European partners of the EAP-recipient countries. Similarly, a different measurement of inequality that incorporates for instance public goods and services, such as the provision of healthcare but also, especially in the long-run, education, would likely yield less positive results regarding the distributive effects of austerity. This reveals a pervasive problem in how scholars and policy makers alike conceptualise inequality. It also illustrates that even when policy makers make a concerted effort to design reforms in a progressive manner, this may have dramatically negative effects on vulnerable groups in the population simply because variables relating to the above-outlined factors do not enter the models of economists and policy makers which still largely rely on a rather antiquated measurement of inequality based on the notions of disposable incomes.

1.4.5 Progressive by design? Policy preferences and aims of the Troika institutions

1.4.5.a The importance of policy preferences in explaining the distributive effects of the EAPs. What, who, and why?

The empirical analysis of the distributive effects of the EAPs produced no evidence in support of H_1. On the other hand, the analysis yielded evidence in support of H_2.

To recapitulate, H_2 hypothesises that the distributive effects of austerity measures depend on their exact design rather than whether they are based more strongly on expenditure- or revenue-based measures. At its core, this hypothesis rests on the notion that in determining the reform design policy makers choose from a set of options available to them and that the choices they make reflect their aims and preferences. The evidence presented thus far in this section provides a strong empirical case for the centrality of the design of austerity measures in determining their distributive effects. However, further investigation is required to ascertain whether the observed distributive effects in fact match the aims and preferences of the policy makers involved in the adjustment process or whether they are a mere unintended outcome. In the particular cases of the Eurozone EAPs, the reforms were not the sole product of domestic political processes but were negotiated with and arguably imposed by the Troika, which is why the following analysis focuses on the Troika institutions rather than the domestic governments of the programme recipient countries.

Importantly, the findings presented so far in this paper seem puzzling given that none of the three Troika institutions would ordinarily be characterised as an advocate for more redistribution and lower income inequality: In the past, the European Commission supported distinctly market-friendly economic policies where concerns about inequality were of little importance and substantive redistribution seen as problematic under the stipulations of fiscal conservatism enshrined in the Stability and Growth Pact (Gill 1998; Fitoussi and Saraceno 2013; see also Beckfield 2019). Furthermore, due to institutional asymmetries inherent in the European integration process, the EU has been characterised by what Scharpf explained as a 'negative integration bias' pushing forward deregulation at the national level without reregulation at the EU level (Scharpf 1999). This constitutes a structural impediment to introducing more strongly redistributive policies aimed at lowering inequality. The ECB, as the second Troika institution, is predominantly concerned with price stability due to its narrow mandate and thus traditionally had little to say about inequality and redistribution aside from pushing towards the strict adherence to fiscal rules so as to not jeopardise the stability of the common currency. Indirectly, however, this made the strengthening of redistributive policies difficult as they were often seen as standing in opposition to the fiscal prudence advocated for by the Bank. Lastly, the IMF came to be seen as a global champion of so-called neoliberal economic policies and particularly in the context of fiscal adjustment has amassed a reputation to "impos[e] austerity policies that have harsh social consequences" (Nelson 2014, 1; see also Kentikelenis, Stubbs, and King 2016; Meltzer 2004; Peet 2009). The progressive effects of the EAPs presented in the previous part of this section thus seem at odds with these conceptions of the three Troika institutions.

Therefore, this section serves to identify the Troika institutions' preferences regarding inequality and redistribution as laid down in the EAP-related policy documents, as well as secondary sources such as speeches and public statements by and interviews with senior officials from the Troika institutions. At the same time it is necessary to disaggregate the Troika, which is made up of three rather different institutions with potentially different aims and motivations. Moreover, the origins of these preferences are discussed in order to address the dissonance between accounts that ascribe the Troika institutions the role of neoliberal champions and the counterintuitive distributive effects of the EAPs presented earlier in this section.

1.4.5.b What: The preferences of the Troika reflected in the EAP-related documents

The analysis of the texts of the EAPs and MoU yields the following. Throughout the documents, the importance of designing the reforms in a manner that protects the most vulnerable from the most adverse effects of the reforms is stressed repeatedly. A passage from the first EAP for Greece states the following:

> "[The aim is that] the **fiscal adjustment is fairly distributed across the society, and protects the most vulnerable** [...] The choice of the fiscal consolidation measures and structural reforms has taken into account the social dimension, and the government has made a commitment to fairness in their implementation. The lowest-income and lowest-pension earners, as well as **the most vulnerable and those requiring family support, will all be protected and compensated** for the adverse impact of the adjustment policies" (European Commission 2010a, 33);

And further in the MoU signed by the Greek authorities:

> "The government is committed to fairness in the distribution of the adjustment burden. Our resolve to **protect the most vulnerable in society** from the effects of the economic downturn was taken into account in the design of the adjustment policies. [...] With regard to the reduction in public wages and in pensions, the minimum earners have been protected" (ibid., 46).

Moreover, throughout the documents particular measures to achieve fiscal consolidation while protecting the most vulnerable groups are specified in a way that matches the observed distributive effects presented earlier in this section. For instance, the first EAP for Greece states with regard to pension reforms:

> "**The elimination of the 13th and 14th pensions is compensated, for those receiving less than €2500 a month**, by introducing a new flat bonus of €800 a year. The benefit reduction is weighted toward the higher pension earners";

And further:

> "minimum pensions and family support instruments will not be cut, and **the most vulnerable will be compensated** for the possible adverse impact of policies";

With regard to public sector employee salaries, the EAP reads:

> "The 13th and the 14th wage payments will be eliminated for all employees. **To protect the lower income segment**, here too, for those receiving less than €3000 a month, a flat bonus payment of €1000 a year per employee will be introduced, which will be financed through cutting salary allowances for higher income segments" (ibid., 46f.).

In a similar vein, the documents outline the introduction of stronger means-testing in order to achieve progressive fiscal consolidation specifically:

> "The scope for improvements in the targeting of social expenditures will be revised in order to **enhance the social safety net for the most vulnerable**" (ibid., 56),

and further outlines the aim to

> "[introduce] a means-tested minimum guaranteed income for elderly people (above the statutory retirement age), to **protect the most vulnerable groups**, consistent with fiscal sustainability" (ibid., 69).

The documents of the Portuguese EAP contain similar sections stipulating that

> "tax increases on income are **designed in such a way as to protect the most vulnerable segments of the population**" (European Commission 2011c, 20)

and further:

> "Fiscal policy objectives [include the reduction of] the Government deficit [...] by means of high-quality permanent measures and **minimising the impact of consolidation on vulnerable groups**" (ibid., 59).

In the MoU the Portuguese authorities specify this:

> "In choosing fiscal measures, **we have taken care to protect vulnerable groups**. The 5 percent cut in nominal public sector wages and the freezing of pensions in 2011 exempt those earning the lowest wages and pensions. The special contribution on pensions will be levied only above a monthly threshold of €1,500. The means-testing program is being enhanced by applying unified and consistent selection criteria throughout the transfers system. In the health sector, an exemption threshold will be introduced to protect the more vulnerable from the proposed "moderating fees" (for health care) increases and the reduction in exemptions. The exemption threshold based on the value of the property will be kept." (ibid., 43)

Strikingly, the European Commission's ex-post evaluation report for Portugal shows that the reform measures implemented by the government did not go far enough with regard to protecting the most vulnerable, especially by introducing means-testing elements, according to the Commission:

> "**Some fiscal measures** – such as the reform of the minimum income guaranteed scheme – **were regressive and could have been avoided** or limited in scope. The historically very high poverty and income inequality levels of Portugal indicated that there was scope for clear improvement of the social protection system. The efficiency of the social expenditure to ensure proper targeting to the most in need and adequate incentives could have been strengthened during the programme." (European Commission 2016, 13)

<u>1.4.5.c Who: Disentangling the different Troika institutions</u>

In the official documents signed by the Troika and the domestic governments prior to and during the adjustment process, the official positions of the Troika institutions are presented as consensus-based. However, it is theoretically possible that the progressive nature of some of the fiscal reforms could be traced to one institution in particular. Therefore, the different preferences of the Troika institutions must be disentangled beyond what can be found in the EAP documents.

In this context it is first necessary to discuss the role of the ECB in the adjustment process: While the ECB was part of the Troika it filled out an advisory role and unlike the IMF or the EMU member states represented by the Commission, it did not contribute funds to the bailout programmes. Nevertheless, a number of commentators argue that the ECB in fact overstepped its mandate by interfering in policy decisions that did not directly concern price stability (Chopra 2015; Gros 2015; Whelan 2012), championing distinctly hawkish fiscal positions (Brunnermeier, James, and Landau 2016, 335ff.; see also Woodruff 2016). This is unsurprising given that fiscal policy directly concerns central bankers because of its interdependence with monetary policy objectives (Ban and Patenaude 2018; Gabor 2016) and is in line with research showing that central banks' communication on fiscal policy issues intensified since the GFC (Allard et al. 2013). Moreover, the ECB has recently begun conducting research looking at the effects of monetary policy on inequality (Ampudia et al. 2018; Lenza and Slacalek 2018).

However, the EAPs predated this recent turn in the ECB's attention to matters of inequality and redistribution. As for the period of the adjustment programmes, there is no evidence in the EAP-related documents, statements made by Bank officials, and interviews that the ECB interfered with decisions on policy reforms expressly with regard to how the adjustment burden is distributed and how reforms affect different social groups. Its primary concern throughout the reform process was the general success of the programmes and the adherence to fiscal targets. Therefore, this paper focuses on the European Commission and the IMF and their positions regarding the distributive effects of the fiscal reforms prescribed in the EAPs.

Firstly, it is also important to note in this context that the IMF was brought on in order for the European Troika institutions to benefit from the IMF's experience and expertise in matters of economic adjustment, which, at that point, the Commission lacked (Brunnermeier, James, and Landau 2016). Of course, despite the formulations in the EAP-related documents suggesting consensus-based decision-making, in reality there were tensions between the different Troika partners, and in particular the IMF on one side and the Commission (and ECB) on the other side, particularly with regard to the question of debt restructuring (ibid., 303ff.).

However, there is no evidence in these documents that the dissent between IMF and Commission extended to the question of how the adjustment burden was to be distributed among different social groups. Beyond the EAPs, the individual positions of the two institutions can be gauged from other documents: The IMF published its own evaluations of the programmes after their conclusions which allow us to approximate the Fund's positions on this question by analysing how it individually assessed the success of the programmes with regard to their distributive effects. Moreover, of the three Greek programmes, the IMF was only part of the first two until 2015. Therefore, gauging the distributive effects of the programme before and after the IMF's departure allows for some conclusions on the impact of IMF involvement. Similarly, documents related to the third EAP for Greece such as the Commission's Social Impact Report reflect more directly the Commission's positions on inequality and redistribution.

These documents demonstrate that the IMF had distinctly progressive positions and that it was a priority for the Fund to design the reforms in a way that was as socially acceptable as possible. With regard to the first two EAPs for Greece, the IMF praises the implementation of some reform measures while criticising others for lacking progressive distributive effects. For instance, public sector wage cuts were indeed carried out protecting lower income groups:

> "Public sector wages and pensions were cut through elimination of 13th and 14th monthly payments, **but with safeguards intended to protect the most vulnerable**" (International Monetary Fund 2013, 14)

Conversely, reforms in the tax system were deemed insufficient with regard to making taxation more equitable:

> "The absence of quick progress in collecting evaded taxes came at the cost of any demonstrable improvement in the equity of the tax burden." (ibid., 24)
>
> "Limited progress was made in checking tax evasion and making the tax burden more equitable, potentially fanning public opposition to the program." (ibid., 41)

In the same vein, the IMF establishes that too little was done to make benefit payments more progressive by excluding higher income groups: "programs for social protection remained largely untargeted and inefficient" (ibid., 16).

Similar passages calling for more progressive reforms, particularly including more equitable taxation and stronger targeting of benefits, can be found in the post-programme evaluation for the second EAP for Greece, which states:

> "Directors called for rebalancing fiscal policy by broadening the personal income tax base and rationalizing pension spending to make room for targeted social assistance to vulnerable groups and lower tax rates. Going forward, [the] development of targeted social safety nets are particularly important for making adjustment more durable and equitable." (International Monetary Fund 2017, 2)
>
> "In terms of the composition of fiscal adjustment, the objectives set out in the EFF request were not met. [...] Staff argued for more equitable taxation (including better enforcement and a broadening of the tax base), improvements in the social safety net, and more sustainable wage and pensions expenditures." (ibid., 19)
>
> "Contrary to the spirit of the program and despite persistent efforts by staff, the composition of fiscal adjustment was not

> socially equitable, raising concerns about the political sustainability of the achieved fiscal consolidation. Enforcement of tax compliance, development of targeted social safety nets, and pension reform are particularly important for making the adjustment more durable and equitable." (ibid., 38)

As for the European Commission, after the departure of the IMF and with the launch of the third EAP, a report was published outlining the social impact of the planned reforms, which reflects more distinctly the Commission's positions. The report asks three questions in particular: (1) How is the burden of adjustment spread across society? (2) What are the reform measures that would have a positive direct impact on the social situation? (3) Which measures would help mitigate social hardships? The existence of the report itself, as well as the focus not just on analysing the social impact of the reforms but specifically on how to mitigate adverse effects on the most vulnerable suggests that the Commission was mindful of the distributive effects of the reforms and sought to design them in a progressive manner. More specifically, the report states:

> "President Juncker made clear on several occasions that social considerations have been explicitly introduced or reinforced in the text of the MoU at the insistence of the Commission. This includes measures to support the most vulnerable and to ensure the fair sharing of the adjustment process – for instance through the phasing in of a guaranteed minimum income scheme [...]; making sure that the efforts required from everyone are proportionate to their income; targeting savings in areas which do not directly affect the disposable income of ordinary citizens [...]; challenging vested interests, such as phasing out favourable tax treatments for ship-owners or farmers." (European Commission 2015, 3)

Moreover, disaggregating the observed distributive effects of the reforms in Greece annually reveals the following: After the departure of the IMF from the Troika, the effects of the reforms remained similar throughout the third EAP for Greece, showing a further relative increase in the lowest decile's disposable income due to the reforms. This suggests congruence of both the IMF's and the Commission's preferences regarding the distributive nature of the reform programmes.

The evaluation of the Portuguese programme is less detailed on the part of the IMF and less focused on the issue of inequality and redistribution. It does reaffirm, however, that the IMF sought to make the reforms as progressive as possible, for instance by introducing stronger means-testing elements in the benefit system: "Directors called for a comprehensive spending review, aiming particularly at better means-testing of social benefits and controlling pensions and public sector wages" (International Monetary Fund 2016, 2). It also reiterates that any expenditure cuts were "designed to cushion the impact on vulnerable groups" (ibid., 9). The IMF's evaluation further reveals that a number of reforms with potentially progressive effects such as the 2012 pension reform were blocked or reversed by the Portuguese Constitutional Court (ibid., 18) much to the frustration of IMF staff.

The Commission was more explicit in characterising the reform progress in Portugal as insufficient with regard to more effective redistribution towards vulnerable groups:

> "The efficiency of the social expenditure to ensure proper targeting to the most in need and adequate incentives could have been strengthened during the programme" (European Commission 2016, 13).
>
> "The programme had room to improve the design of social protection expenditure to promote effectiveness and equity" (ibid., 113).

Similarly, while attesting that some reforms such as wage and pension cuts were implemented in a progressive way, the evaluation report by the Commission ascertains that

> "Some other measures (or lack thereof) failed to ensure progressivity in the burden-sharing of the adjustment or in protecting the lowest income groups. Some measures were repeatedly negotiated and even announced but never implemented by the government, like a cap on accumulated social benefits, including those provided by local governments. [...] This leads to the view that not all segments of the society participated in the burden sharing of the needed adjustment" (ibid., 115).

The evidence from the post-programme evaluations conducted individually by the IMF and the European Commission respectively, as well as the social impact report of the third EAP for Greece compiled by the Commission, and the distributive effects of the third Greek EAP after the departure of the IMF suggest that there was little dissent between the two institutions with respect to the issue of inequality and redistribution. Both institutions sought to achieve a progressive design of the reform measures aimed at shielding the most vulnerable groups from the adverse effects of the reforms.

1.4.5.d Why: The aims and ideas of the Troika behind the preferences laid out in the EAPs

How can this unexpected finding be explained given that none of the Troika institutions traditionally had a reputation for championing redistributive policies and prioritising the preclusion of inequality?

The documents signal that the answer lies partly in purely strategic calculations on part of the Troika. The first EAP for Greece reads: "These [measures designed to protect the most vulnerable groups] are important conditions to ensure broad support for the programme" (European Commission 2010a, 33). In other words, the Troika acknowledges that reform prescriptions that would increase inequality are more likely to trigger social unrest and thus jeopardise the success of the consolidation efforts. In the same way that frontloading the measures was a key principle of the programmes in order to achieve as much consolidation as possible before effective resistance to the reforms could form, the progressive design was partly a means to an end for the Troika to maximise chances of successful completion of the economic adjustment process, and thus ultimately to guarantee the repayment of the loans given to the programme recipient countries. At this point it is important to understand that the Troika's somewhat unexpected approach regarding the distributive effects of the reforms does not impinge on the general austerity paradigm. While the debate around fiscal multipliers (Blanchard and Leigh 2013) more than questioned the economic success of the austerity measures, it is clear from the various institutional, ideational, and political reasons (see introduction to this thesis) that there would be no significant divergence from the path of fiscal consolidation. It is vital to not confuse this with the question of the direct distributive effects of these measures: within the constraints of the austerity-heavy approach, which in itself had dramatic effects on for instance unemployment and poverty, there seems to have been a genuine effort to make the reforms that were deemed necessary by the Troika as progressive as possible.

Even beyond this general motivation to ensure the success of the programme, it is, in fact, not surprising that the Troika institutions should be mindful of the social impact of their policy prescriptions, although different motivations can be identified for the European Commission and the IMF.

The European Commission is arguably the most political out of the three institutions with the most accountability towards the peoples of the member states. Nevertheless, precisely its accountability towards the European peoples and by extension its democratic legitimacy is one of the most problematic traits of the European institutions in general and the Commission in particular (Beetham and Lord 1998; Moravcsik 2002). The charge of a lack of democratic legitimacy rests primarily on the Commission's deficiency in the input dimension of legitimacy which is derived from the participation of the people (Hix 2008). Effectively, this leaves the output dimension as the Commission's remaining pathway to satisfy the requirements of a democratically legitimate institution (Majone 1998). Implementing austerity measures, which are in any case painful for the populations of the respective countries, in a way that would also put most of the adjustment burden on lower incomes and thus more vulnerable households would almost certainly be perceived as a negative outcome for the people and thus undermine the democratic legitimacy of the responsible institution. Therefore, even a cynical view of European bureaucrats as self-interested budget-maximisers (Niskanen 1971) provides grounds for why the Commission would favour more progressive austerity measures: A further deterioration of the EU's perceived output legitimacy has the potential to endanger the entire European project and thus threaten the very existence of its institutions, as has become clear with the recent upsurge of Euroscepticism.

It also needs to be noted that the European Commission faced a dilemma: On the one hand it needed to be mindful of the accountability it has towards all member states and in particular heed the powerful coalition of interests in the Council built around the creditor countries, most notably Germany. This translated into a particularly hawkish stance on austerity and the insistence on the repayment of the loans, while others, and most notably the IMF, softened their stance somewhat having accepted the inevitability of a haircut (Henning 2017). On the other hand, the technocrats within the Commission, while accepting the general austerity paradigm, had their own ideas regarding the specific design of the austerity measures they were imposing on the EAP countries, and especially their social impact. The following elaborates on this point in more detail.

There is evidence that Commission officials, in fact, have a strong predisposition towards policies based upon a more regulated form of capitalism, as well as enshrining a stronger social dimension in the European integration project characterised by more extensive social services and higher levels of redistribution (Hooghe 2000; 2001; Ross 1995). At the same time, interview evidence shows that Commission officials express a degree of concern that the European social model is increasingly under pressure and that they would prefer a stronger orientation towards policies that ensure more equity through redistribution (Ross 2011, 43f.). In fact, one must not forget that the European social model is enshrined in the Treaties, with Article 151 of the Treaty on the Functioning of the European Union stipulating that member states and the EU "shall have as their objectives the promotion of employment, improved living and working conditions [and] proper social protection" (*Treaty on the Functioning of the European Union* 2009). The Commission as per Article 17 of the Treaty on European Union is the "guardian of the EU Treaties", including the European social model, and tasked with defending and enforcing its principles and ensuring compliance by member states (*Treaty on European Union* 1992).

The accountability towards the hawkish governments of the creditor countries (as well as the simple truth that any bailout would require the agreement of these governments, thus significantly shifting bargaining power in their favour) on the one hand, and the European social model enshrined in the Treaties on the other hand, further underscores the idea that Commission officials may have found themselves caught between a rock and a hard place called Berlin. A solution to this dilemma is offered by viewing the economic adjustment programmes as what Mahoney and Thelen (2010) call 'soft spots' in the historical institutionalist sense that can be utilised by agents to achieve gradual change (see also Streeck and Thelen 2005; Thelen 2003; 2009). Following this logic, the EAPs provided a window of opportunity for Commission bureaucrats to realise changes towards more efficient redistribution and generally ensure the protection or compensation of vulnerable households from the most adverse effects of the adjustment process without jeopardising the primary goal of fiscal consolidation.

In the following, the paper presents further evidence of the ideas of Commission officials regarding social Europe and inequality and redistribution in the particular context of the adjustment programmes. For that purpose, a corpus of over 250 sources, including interviews, speeches, public statements, press releases, as well as newspaper articles and other journalistic reports, was surveyed for content by European Commission officials and representatives relating directly to the economic adjustment reform programmes in Greece and Portugal. Subsequently, similar evidence is given for the IMF. The ECB, despite its merely consultative role, took a strong stance on fiscal policy and pushed for a particularly hawkish position (see also Woodruff's conceptualisation of the ECB 'governing by panic', 2016). However, with regard to the EAPs and their distributive effects in particular, the ECB did not communicate any particular position openly. The paper follows approaches used in a number of accounts of the Eurozone crisis and the economic adjustment process in order to gauge the preferences and ideas of the involved policy makers, including Henning (2017) and Ramalho (2020; see also Fairclough and Fairclough 2013).

It is apparent from a number of statements made by the Commission's Task Force for Greece that the Commission, albeit sticking to the austerity paradigm, sought to use the opportunity of the far-reaching reform programmes to ensure a fairer design of the welfare state. In 2011, after the inception of the programme and initial difficulties (see Paper 2 for a discussion of the tighter control exercised by the Troika after the year of the EAP for Greece), the Task Force voiced cautious optimism in combining the two goals of fiscal consolidation and welfare state modernisation, stating that "a stronger and fairer tax system will make a significant contribution to fiscal consolidation and social equity" (European Commission 2011a). The words by the Task Force were echoed by then-Commissioner for Economic and Financial Affairs, Olli Rehn, who outlined the Commission's duty to "help Greece implement essential reforms to boost its competitiveness, create a fairer and more effective tax system, and generate sustainable growth and employment" (Rehn 2012) again exhibiting that even endorsing fiscally hawkish positions, as did Rehn, was not considered by the Commission to be mutually exclusive with modernising a tax system and making it fairer and more equitable. A good two years later, and after the Troika had markedly changed their approach to managing the adjustment process in Greece, the Task Force doubled down on this claim in their sixth activity report stating that the further modernisation of the tax system is "essential to enable Greek authorities to increase public revenues and to deliver a fairer, more equitable distribution of the tax burden" (European Commission 2014).

Such statements are mirrored by the ideas and preferences voiced at the highest levels of the Commission. In 2012, Commission President José Manuel Barroso said in a speech given to the European Parliament after the Spring Council Meeting:

> "I also made clear that we need a perspective of social inclusion because there are some situations of social emergency, raising poverty in many of our Member States. [...] I made the point that structural reform must be politically, but also socially acceptable to our citizens. [...] This is one element in demonstrating that the path we are taking is a fair one, where the burden and the benefits are both shared" (Barroso 2012)

One year later, in a speech from 2013, Barroso reiterates this point as well as relating it to the Commission's fundamental responsibility and commitment to the European Social Model as stipulated in the Treaties:

> "From its inception, European integration was always a way to close gaps: gaps between its Member States, differences between regions, disparities between rich and poor. In the current treaty, the Lisbon Treaty, this goal is specified as such: 'The Union shall... work for... a highly competitive social market economy, aiming at full employment and social progress... It shall combat social exclusion and discrimination, and shall promote social justice and protection... It shall promote economic, social and territorial cohesion, and solidarity among Member States.'" (Barroso 2013)

Jean-Claude Juncker, during his tenure as European Commission president, continued on the same path. Next to the comprehensive Social Impact Report already mentioned in the previous section, he stated repeatedly that the distributive effects of the further adjustment process in Greece are important and that it is vital to ensure that reforms are designed in an equitable manner. In June 2015, he said:

> "I know the hardship [the Greek people] have been through and I have always said that we have to pay more attention to the social fairness of our programmes. [...] This is certainly a demanding and comprehensive package, but it is a fair one." (Juncker 2015)

The thrust in making sure that austerity measures were at least designed in a progressive manner received a further push when Pierre Moscovici became Olli Rehn's successor as Commissioner for Economic and Financial Affairs. During his tenure as French Finance Minister, Moscovici was a vocal opponent of austerity measures, which he viewed as a political imposition of 'strict financial orthodoxy' that only served to crush consumption, employment and investment (Moscovici 2012). He emphasised distinctly that fiscal consolidation programme ultimately implemented under the Hollande government was more progressive, and cuts were not executed cutting indiscriminately and irrespective of their social impact (McDaniel 2019, 184f.). During his tenure as Commissioner, Moscovici reiterated in a speech from 2016 that as part of the wider reforms necessary for the European Union, "reducing inequalities while generating prosperity must be the absolute priority" (Moscovici 2016). In the later stages of the adjustment process, when economic recovery was under way, Moscovici continuously stressed this point, saying "The European crisis is no more an economic crisis. It is an inequality crisis" (Bases 2018)

The case is more complex for the IMF due to its lower or rather different accountability. At the same time it also seems less plausible that the IMF should promote redistributive policies with the aim of lowering inequality given its track record in past surveillance programmes. However, in the more recent past, the IMF has been subjected to heavy criticism for its handling of the East Asian Crisis to the point where its institutional legitimacy was under threat (Chwieroth 2009). Putting a stronger emphasis on prescribing socially acceptable reforms rather than imposing Washington-Consensus-style austerity measures thus may have been part of a process of institutional learning. Indeed, there is evidence from official documents, research papers, and public statements made by senior staff that this has been the case, and that the Fund adopted a more positive stance towards policies that are aimed at avoiding increases in inequality, including measures that entail higher levels of redistribution. However, the observable change is rather incremental and therefore does not necessarily require a fundamentally new understanding of how the IMF works; achieving economic growth still is the primary policy objective for IMF surveillance programmes. The important difference is that inequality now appears to be taken as an important factor to consider when designing policies best-suited to stimulate and maintain economic growth.

To develop this argument it is first necessary to better understand the IMF's self-conception and internal workings. The IMF as an institution understands itself to be apolitical, pragmatic and promoting what they take to be 'sound economic policy'. What constitutes sound economic policy is in turn defined by economic ideas legitimised through cutting-edge research at leading economics departments (Ban and Patenaude 2018). A dispute between different economic ideas such as orthodox and revisionist understandings of economic policy is thus usually reflected in the IMF's position on certain topics rather than promoting one or the other[22]. This implies a certain heterogeneity of economic ideas within the Fund itself. Indeed, the IMF is characterised by internal struggles among different ideas and subcultures that promote one or the other before they are formalised (Ban 2015; Chwieroth 2009). This is evidenced both in interviews with Fund staff (Ban and Patenaude 2018; Clift 2018), official documents published by the IMF (Ban 2016), and public statements made by Fund officials (Rodrik 2006).

In the case of the IMF's position regarding inequality and redistribution in the Eurozone economic adjustment programmes, this process can be traced back to the aftermath of the East Asian Crisis and the Global Financial Crisis as a critical juncture (Capoccia and Kelemen 2007; Collier and Collier 2002; Thelen 1999; Lipset and Rokkan 1967) triggering a rethinking of previously held beliefs. The economic orthodoxy of the pre-GFC era was questioned by influential economists shifting towards more market scepticism and openness to interventionist policies (see e.g. Auerbach and Gorodnichenko 2012; DeLong et al. 2012). At the same time, a growing body of research on the causes and levels of economic inequality spearheaded by economists such as Tony Atkinson, Thomas Piketty, and Emmanuel Saez gave more salience to the issue of economic inequality within the economics profession as a whole (Atkinson 1997; 2015; Atkinson, Piketty, and Saez 2011; Piketty and Saez 2003; 2014).

[22] The fact that economic policies advocated by the IMF overlapped with neoliberal principles for the better part of two decades since the 1980s is thus more of a reflection of the then consensus in the economics profession after the turn towards neoclassical economics rather than a sign of ideological fealty in its own right.

Research from within the IMF mirrored this development both with regard to a generally more market sceptic view of economic policy (Cottarelli and Jaramillo 2012) and the issue of inequality as an impediment to sustainable long-term growth. In two much-cited papers from 2011 and 2014, senior IMF staff argue that high levels of inequality are harmful to long-term economic growth (Berg and Ostry 2011; Ostry, Berg, and Tsangarides 2014). Still cautious with regard to sweeping policy recommendations, the authors show furthermore that there is no empirical evidence that non-excessive forms of redistribution should harm economic growth, thus rebuffing the notion of a possible equity-efficiency-trade-off. In fact, the authors argue, sensible forms of redistribution can contribute to higher and more sustainable economic growth.

Evidence from interviews with and speeches by senior IMF officials reveal two channels explaining the observed negative relationship of high inequality and sustainable economic growth. Firstly, higher levels of redistribution can facilitate growth directly: Based on lower income households' higher marginal propensity to consume, redistribution towards these households has larger multiplier effects (Kalecki 1971). In other words, as lower income households spend a larger share of their income, policies that increase their income lead to higher consumption and thus boost economic growth. Jonathan Ostry, Deputy Director of the IMF's Research Department notes that:

> "Fiscal policy, fortuitously, is more potent in periods of economic slack such as the aftermath of the global financial crisis, so it makes sense to use it. And to use it not only for counter-cyclical purposes, but also to facilitate redistribution, which itself can help to spur economic growth." (Ostry in Clift 2018, 82).

Ostry reaffirms that in his opinion this does not constitute a radical shift in the IMF's priorities:

> "A core objective of the Fund is to come up with policy advice that underpins macro-financial stability. So if we can show that avoiding excessive inequality is in fact essential for strong, healthy and sustainable growth (which I believe the research I

> have been engaged in does show), then indeed there is a direct link between issues of inequality and distribution and issues that lie at the core of the IMF's mandate." (ibid., 21f.)

Secondly, specifically in the case of fiscal consolidation, the IMF, like the European Commission, identifies public support as a key prerequisite for a successful adjustment process and by extension economic recovery through growth-inducing reforms. Deputy Managing Director David Lipton stated in his opening remarks to the IMF's Fiscal Forum 2013:

> "Generating public support is necessary for fiscal adjustment. Adjustment fatigue [...] undermines the gradual progress that is being made towards restoring fiscal sustainability. [Making fiscal adjustment] balanced and equitable [...] is critical for building public support and maintaining it." (Lipton 2013)

Internally, this process was driven forward by change-agents such as Dominique Strauss-Kahn who pushed concerns over how policies in response to the GFC would affect inequality further up on the IMF's agenda. Under Strauss-Kahn's tenure as Managing Director a number of likeminded economists were appointed to senior positions including Olivier Blanchard as Chief Economist and Carlo Cottarelli as Director of the Fiscal Affairs Department. The importance of these individuals actors and the impact that their ideas had on the general direction taken by the Fund with regard to the distributive effects of their reforms, cannot be overstated. For Clift, who has worked extensively on the internal change processes within the IMF, these powerful change-agents, or 'bricoleurs', played a central role in the IMF's novel appreciation of the social dimension of the reforms prescribed to programme countries (Clift 2018). In May 2011, the Economist wrote about the specific role of Dominique Strauss-Kahn in this process:

> "Before his fall, Mr Strauss-Kahn had done more than any other recent managing director to restore the IMF's reputation. A few years ago the fund's very relevance was being questioned. But his early and prescient endorsement of fiscal stimulus during the

> crisis was taken seriously and acted upon. [...] His championing of the need to insulate the poor from the effects of fiscal austerity has, many believe, led the fund to become kinder and gentler" (*The Economist* 2011)

It is no coincidence that one of the proponents of *progressive* austerity in the European Commission, Pierre Moscovici, had close ties to Strauss-Kahn who had been a political mentor of his up until Strauss-Kahn's sexual assault charges came to light. Having been one of his students at the French elite ENA civil service academy, Moscovici later became president of the group *à gauche en Europe*, which Strauss-Kahn had founded together with former socialist Prime Minister Michel Rocard, and would go on to work for Strauss-Kahn for a number of years including during his unsuccessful bid for the French Presidency in 2007 (Flynn 2012).

Christine Lagarde, having succeeded Dominque Strauss-Kahn as IMF Managing Director, continued to facilitate the process of change begun under her predecessor and asserted in a speech at the Conference on Inclusive Capitalism in 2014:

> "One of the leading economic stories of our time is rising income inequality. [...] Fundamentally, excessive inequality makes capitalism less inclusive. It hinders people from participating fully and developing their potential [...] Redistributive policies always produce winners and losers. Yet if we want capitalism to do its job – enabling as many people as possible to participate and benefit from the economy – then it needs to be more inclusive." (Lagarde 2014)

The new-found appreciation of excessive inequality as an obstacle to long-term economic growth as well as a valid target for government intervention through redistributive efforts is reflected even in flagship IMF publications such as the *World Economic Outlook*, which by 2014 stated in its foreword:

> "Though inequality has always been perceived to be a central issue, until recently it was not believed to have major implications for macroeconomic developments. This belief is increasingly called into question. How inequality affects both the macroeconomy and the design of macroeconomic policy will likely be increasingly important items on our agenda." (Blanchard 2014, xiii)

Similarly, in a much-noticed article from 2016 tellingly titled *Neoliberalism: Oversold?* (Ostry, Loungani, and Furceri 2016), senior IMF researchers reiterate the argument that inequality is harmful for long-term growth and state that even those that subscribe to a neoliberal view of how the economy should work and are only concerned with achieving economic growth, "still need to pay attention to the distributional effects." The article even goes so far as to question a whole economic paradigm and calls for "a more nuanced view of what the neoliberal agenda is likely to be able to achieve". In reaction to the article, then-IMF Chief Economist Maurice Obstfeld stated revealingly:

> "[this article] does not signify a major change in the Fund's approach. [...] We are in favor of fiscal policies that support growth and equity over the long term. [...] Our job is to advise how governments can best manage their fiscal policies so as to avoid bad outcomes. Sometimes, this requires us to recognize situations in which excessive budget cutting can be counterproductive to growth, equity, and even fiscal sustainability goals." (Obstfeld 2016)

Therefore, this gradual change within the IMF and its policies can be conceived of as follows: First, a set of newer ideas (or rather ideas different from the orthodoxy) – such as a more critical stance towards markets and the view that inequality needs to be tackled through redistributive measures in order to ensure economic growth – takes hold. Second, through ideational struggle within the Fund, this set of ideas supersedes previously dominant ones, often catalysed by critical juncture events such as the GFC calling the validity of the previously dominant orthodoxy into question. Moreover, in order for different sets of ideas to be empowered they require the legitimation through credible research, usually from top economics departments in the US and around the world, as well as in-house research by the IMF. This process can be accelerated and shaped substantially by powerful change-agents within the institution by giving out policy directives or appointing similarly-minded agents to influential positions within the institution. Third, given the hierarchical nature of the IMF, new ideas, once they have taken hold, are diffused swiftly and translate into concrete policies (Clift 2018; Copelovitch 2010; Momani 2007). Ultimately, this interplay of ideational struggle on the one hand, and the top-down organisational form of the IMF on the other hand, led to these new ideas regarding the centrality of inequality as an important issue for the Fund shaping the policy prescriptions found in the EAPs in the Eurozone crisis.

In conclusion, both the European Commission and the IMF thus advocate for a progressive design of the reforms, as is evidenced in the Troika documents and the individually compiled post-programme evaluations. This is due to strategic considerations on the part of both institutions given that a progressive design of the programme is most likely to maintain public support for the reforms and thus ensure the success of the programme. Moreover, there is evidence that the IMF in particular underwent a gradual change characterised by a reorientation of what the Fund holds to be 'sound economic policy' towards a more positive view of redistribution due to research pointing to negative effects of high levels of income inequality on economic growth.

1.4.6 Discussion of the findings

This section produced a number of findings. Firstly, the analysis of EU-SILC data show that inequality did not increase throughout the duration of the Greek and Portuguese EAPs. Secondly, microsimulations with EUROMOD show that the reform prescriptions actually had inequality-reducing effects. Considering that both Greece and Portugal were not only plagued by high public debt when the economic adjustment programmes were implemented, but also by a severe economic recession, this is all the more puzzling. During the recession in the programme countries, the respective economies had low economic growth rates and at times shrank considerably, while unemployment rose which was expected to put an upward pressure on income inequality, and which is illustrated by the increases in market income inequality observed in this section (see Figure 5 and Figure 6). At the same time, the level of redistribution, i.e. the difference between market and disposable household income inequality, increased noticeably. This is somewhat common during a recession as automatic stabilisers kick in and increase government spending on certain benefit programmes that have redistributive effects. However, in the two observed cases, the entirety of the increases in market income inequality was absorbed through redistributive measures as illustrated by the fact that disposable income inequality remained stable throughout the crisis.

This is especially remarkable for the Greek case as the EAPs relied heavily on expenditure-based measures, which were expected to exacerbate inequality increases through cuts in the social budget. This should have undermined the welfare state's capacity to mitigate upward pressures on inequality levels, stemming from higher unemployment, by means of redistribution. As this evidently did not occur, based on the findings presented in this section, this suggests that the fiscal consolidation measures outlined in the economic adjustment programmes were in fact progressive in their distributive impact and thus able to offset the upward pressure on inequality levels induced by the economic recession and rising levels of unemployment, as validated by the data from the simulations presented in Figure 11.

The a priori expectations for the Portuguese programme were less clear-cut due to the weaker empirical case of revenue-based programmes causing inequality levels to move in one particular direction. The empirical analysis in this section showed that, at the aggregate level, much like in the Greek case, inequality remained stable throughout the adjustment process with only minor fluctuations, and that this was due to the progressive direct effects of the reforms, as evidenced through the simulations presented in Figure 11. However, one key difference between the Greek and the Portuguese cases, despite aggregate inequality indicators such as the Gini coefficient and the S80/S20 ratio showing similar results, is revealed when decomposing the direct distributive effects of the reforms by deciles: In the Greek case, the bottom decile of the income distribution in fact saw substantive increases in their incomes due to the reforms vis-à-vis the simulated non-reform scenario while the top decile saw the largest losses. In the Portuguese case, it was the middle income groups that were somewhat protected from the adverse effects of the adjustment process, while both the bottom and top income deciles saw the largest aggregate income losses due to the reforms. Neither the Gini coefficient nor the S80/S20 ratio would have picked this up, as the Gini coefficient is in any case rather insensitive towards changes at the tails of the income distribution, and the S80/S20 ratio only looks at the relative ratio between the two top and bottom deciles, thus not capturing the above-outlined changes in the income distribution as long as the ratio between top and bottom deciles remains stable in relative terms.

On the basis of these findings, H_1 (that austerity measures have predetermined effects depending on their composition, i.e. the degree to which they are expenditure- or revenue-based) must be rejected: Firstly, both the Greek and Portuguese EAPs were not accompanied by increases in inequality. In fact, in both cases the reforms served to make the countries' tax-benefit system more redistributive compared with that prior to the reforms. Secondly, the heavily expenditure-based programmes for Greece had more progressive distributive effects than the relatively more revenue-based Portuguese programme. Conversely, there is strong evidence in favour of H_2: Austerity measures seem to have no predetermined distributive effects. Instead whether austerity increases or lowers inequality simply depends on the exact design of the reforms. Measures such as tax increases can be progressive, i.e. lower inequality, if they target higher incomes. Similarly, cuts in social expenditure can have inequality-reducing effects if lower income groups are exempt from the cuts thus compressing the distribution of disposable incomes.

Moreover, the exact design of the reforms is naturally determined by policy makers preferences who have a certain degree of freedom in choosing from a number of available policy options. In the case at hand, the constraints of these options arose from the need for fiscal consolidation. In turn, this means that as long as fiscal consolidation is achieved, policy makers' preferences regarding inequality and redistribution are reflected in both the design of the prescribed reforms and the observed distributive outcomes. In the case of Greece, there is a remarkable congruence of the observed effects and the aims of the policy prescriptions laid out in the EAPs and Memoranda of Understanding. For instance, the introduction of stronger means-testing for benefit payments was prescribed in order to shield lower income groups from adverse effects of the reforms. For Greece, the EUROMOD data confirm that these reforms had precisely the desired effect. In Portugal on the other hand this was not the case and changes in means-testing benefits were regressive. However, spending data suggest that means-tested benefits in Portugal were simply cut rather than being expanded as envisioned in the EAPs. The European Commission's post-programme evaluation for Portugal corroborates this as is evidenced by the Commission's critique of insufficiently implemented reform prescriptions aimed at stronger means-testing of benefits. This suggest that there was some dissonance between the prescribed reforms and those that were eventually implemented and that further research is necessary to explain the reasons for this departure from the originally agreed-upon reforms, which would have likely resulted in similarly progressive distributive effects as those in Greece.

Despite the deviation of the reforms in Portugal from the desired distributive effects, the originally agreed-upon reform prescriptions and formulated aims are in line with the preferences of European Commission and IMF both of which showed a predisposition towards making the reforms as progressive as possible. This is partly because regressive reforms would jeopardise the overall success of the programme – the key priority for the Troika institutions – by undermining public support for the reforms. In addition, both the Commission and the IMF had good reasons to advocate for more socially acceptable reforms: For the Commission this firstly constituted a way to protect its democratic legitimacy by producing positive outcomes for the people (or at least limit the negative outcome in crisis-ridden countries like Greece). Secondly, the EAPs presented an opportunity for Commission bureaucrats to achieve the realisation of at least some elements of a stronger European social model within the confines of harsh austerity. For the IMF, the departure from its previously unconcerned stance towards the issue of inequality was the result of a gradual change originating in the learnings from the East Asia Crisis and the GFC leading to a more positive view towards redistributive policies: Aside from generating public support, recent IMF research finds such measures support economic growth more directly through larger fiscal multipliers by redistributing income towards households at the lower end of the income distribution with a higher marginal propensity to spend.

1.5 Conclusion and Avenues for Further Research

This paper aimed to establish the distributive effects of fiscal consolidation measures in the Eurozone crisis based on a comparative case study of the Greek and Portuguese Economic Adjustment Programmes. While the Greek EAPs were heavily expenditure-based, the Portuguese EAP was revised in its composition and ultimately relied more on revenue-increasing measures rather than expenditure-cuts. Previous studies have found that fiscal consolidation leads to higher levels of income inequality, which is exacerbated when the consolidation is largely based on expenditure measures. Against this background, the paper has shown evidence that this was not the case in either the Greek or the Portuguese EAPs.

In fact, inequality of disposable household income is found to stagnate throughout the duration of the EAPs rather than increasing. In addition, inequality of market income increased substantially in both Greece and Portugal, suggesting that the redistributive capacities of the countries' welfare states have remained intact or even been strengthened. Based on data created through simulations with tax-benefit microsimulation tool EUROMOD, the paper has found that, in addition to this general development of inequality indicators, the fiscal consolidation measures themselves had inequality-reducing direct effects in both countries.

While, based on the findings of previous studies, the revenue-based programme of Portugal was expected to be less inequality-increasing from the outset, it was the progressiveness of the Greek programme that was particularly puzzling. In explaining this puzzle, the paper has shown that expenditure-based fiscal consolidation is possible without crippling the welfare state's redistributive capacities. An analysis of the impact of different classes of policies yielded that Greece managed to avoid large increases in inequality by making large parts of formerly non-means-tested benefits means-tested. In doing so, higher income groups were excluded from receiving these benefits, while lower income groups were compensated. At the same time, expenditure on non-means-tested benefits for high income groups tends to be higher than for low income groups, which makes this approach not only more progressive but also more effective in achieving fiscal consolidation.

On this basis the paper rejects the notion of an automatic relationship between austerity or its composition (expenditure- versus revenue-based) and its distributive effects for the cases of Greece and Portugal. Acknowledging that austerity can take on different forms, the paper finds that the exact design of the reforms is crucial in determining their impact on income inequality. This gives policy makers room for manoeuvre despite the general need for fiscal consolidation. The way in which policy makers decide to use this room in turn depends on their preferences regarding inequality and redistribution.

The paper showed that the Troika expressed a strong interest in keeping inequality increases limited and making the programmes as socially acceptable as possible. This was partly due to strategic considerations: Regressive reforms would have likely jeopardised the success of the programmes through losing public support and creating even stronger opposition to the reforms. This is evidenced by the Troika's policy objectives outlined in the various documents of the EAPs. Moreover, a progressive reform design is in line with the European Commission's need to derive its democratic legitimacy from producing positive outcomes for the peoples of the member states. As for the IMF, the paper presented evidence that the institution underwent an incremental change in its stance on inequality, which the Fund now views as an obstacle to economic growth. Incorporating in the EAPs policies that tackle inequality, such as stronger means-testing, is seen as growth-enhancing and thus in line with IMF preferences.

The evidence presented in the paper raises a number of important questions to be addressed in future research. Firstly, despite the fact that both the Greek and the Portuguese EAPs are similar in the progressiveness of the originally prescribed reforms, the observed outcomes are different along one important dimension. While both programmes led to lower inequality if measured by aggregate indicators such as the Gini coefficient, decomposing the effects by income deciles revealed that in Greece lower income groups were most protected, meanwhile in Portugal middle income groups were protected and both lower and higher income groups lost the most. This divergence in the observable distributive effects suggests that there were deviations from the originally prescribed reform design.

Granted that this warrants closer scrutiny in its own right, it also leads to a further question concerning the responsibility of the policy makers in charge: We know that matters of redistribution are at the core of democratic politics. However, the Troika technocrats are unelected and are therefore not guided in their actions by the desire to be re-elected. The question is therefore whether these dynamics had a bearing on the design of the implemented reforms in the two cases at hand. This is salient given that the reforms were originally *imposed* by unelected technocrats that can all but ignore electoral politics, but had to be *implemented* by elected governments that are exposed to electoral retribution and therefore need to cater to important electoral groups. Paper 2 of this thesis addresses this issue.

A further question that the paper did not address concerns other dimensions of distributive effects of the reforms. Fiscal policy reforms constituted a major part of the economic adjustment programmes. However, they were underpinned by far-reaching structural reforms that potentially followed different dynamics. One question is therefore whether changes in e.g. labour market regulation had similarly progressive consequences or whether these reforms mainly followed principles of deregulation and privatisation with adverse distributive outcomes for more vulnerable groups. Paper 3 of this thesis expands the analysis to the distributive effects of labour market reforms.

In a similar fashion, the paper did not address possible issues with the measurement of inequality more generally. Most indicators measure inequality in relative terms. Therefore, it is possible to see reductions in inequality even if everybody becomes worse off as long those at the upper end of the distribution lose relatively more than those at the lower end. This is true both for income inequality and labour market inequality or any other dimension. Future research therefore needs to address the issue of 'equality in precariousness' or 'progressive impoverishment', as well as incorporating other sources of wellbeing – such as access to public services – that are not taken into purview by commonly-used indicators.

Paper II

Sound economic policy and the median voter: The democratic constraints to progressive policy making

ABSTRACT

Building on the work of the previous paper, this paper zooms further in on the distributive effects of the reform programmes in Greece and Portugal. Using microsimulation techniques, the paper computes the distributive effects of the reforms decomposed by income deciles as well as over time. The key findings that the paper presents are the following: (1) Whilst overall reducing inequality when measured in aggregate terms, the composition by decile reveals that the reforms in Greece were largely protective of the lowest income earners; (2) conversely, in Portugal, the reforms protected middle income groups; (3) In an endeavour to explain these divergent distributive outcomes, the paper finds evidence that the Troika controlled the reform process much more strongly in Greece than in Portugal. The reform effects thus matched more closely the preferences of the unelected technocratic Troika policy makers in Greece, whilst they matched more closely the preferences of the elected government in Portugal. This is because the Troika aimed at redistributing towards lower income groups in order to stimulate economic growth and ensure a minimum degree of public support. The Portuguese government on the other hand displayed preferences ordinarily associated with office-seeking politicians, i.e. the aim to protect the median voter as such policies are understood to be most likely to secure support for the government's re-election. This argument is corroborated further by zooming in on distributive changes per year, which reveals that the Greek EAPs only became progressive, in the sense that they shielded low income earners, from 2012 onwards. This matches the evidence showing that the Troika took stronger control over the reform process from 2012 onwards.

2.1 Introduction

In the wake of the Global Financial Crisis (GFC) and ensuing sovereign debt crisis, several Eurozone member states required government bailouts. In turn, the Troika of International Monetary Fund (IMF), European Commission, and European Central Bank (ECB) administered comprehensive Economic Adjustment Programmes in Greece, Portugal, Ireland and Cyprus. The EAPs of the Eurozone entailed large-scale austerity measures aimed at consolidating public budgets by cutting expenditure or increasing revenues through taxes. Inevitably, the EAPs thus triggered distributional conflicts over how the adjustment burden was to be shared. In the previous paper I have shown by the examples of Greece and Portugal that the austerity measures implemented as part of the EAPs are (1) not associated with a general increase in inequality levels, and (2) can vary across countries, both with regard to their exact design and by extension their distributive effects. In other words, there is no automatism between austerity measures as such and certain distributive outcomes. Instead, these outcomes depend on how policy makers choose to distribute the adjustment burden.

In this paper, I analyse the politics of distributive conflicts arising from fiscal consolidation pressures in Greece and Portugal, thus exploring an important question raised by the findings presented in the previous paper. The central aim of the paper is to answer the following question: What explains the differences in the distributive effects that can be observed as a result of the EAP austerity measures? The paper's key hypothesis is that the nature of the distributive effects depends on the preferences of the policy makers administering the adjustment process – and, more importantly, which policy makers had the strongest influence over the reform process. Whilst much has been written about how elected policy makers typically solve such distributive conflicts, the Eurozone crisis constitutes a more complex case as unelected supranational technocrats were heavily involved in the adjustment process. The preferences of elected policy makers and unelected technocrats are, however, motivated by radically different factors.

Understanding the distributive effects of the EAPs thus requires a two-part analysis: (1) the preferences of each set of policy makers regarding the distribution of the adjustment burden must be explicated; (2) the interaction between elected policy makers of domestic governments with the unelected technocrats of the Troika must be disentangled, to unpick to which degree the reform process was controlled by one or the other. In a second step, the preferences of the different policy makers and the degree of control they exercised over the reform process must be linked to the distributive effects of the EAPs observed in each country.

Building on the work of the previous paper, this paper hypothesises that adjustment programmes that are more tightly controlled by the Troika are more protective of lower income groups. By virtue of being technocratic as opposed to elected policy makers, Troika officials favour policies whose soundness is backed up by empirical evidence and high-level research. On this basis, a gradual ideational shift observable within the economics discipline from a generally more market-oriented economic policy consensus to an increasingly market-sceptic, interventionist economic policy consensus, which originated in the lessons drawn from the Global Financial Crisis, ultimately filtered through to institutions such as the three Troika bodies and shaped their policy preferences (Clift 2018). One important manifestation of this ideational shift is that excessive inequality is increasingly viewed as a hindrance to long-term sustainable growth (Berg and Ostry 2011; Ostry, Berg, and Tsangarides 2014). Simultaneously, more progressive redistributive policies are increasingly seen as effective and valid tools in boosting economic growth by stimulating domestic demand due to lower income households' higher marginal propensity to consume. Thus, avoiding regressive distributive outcomes became an important element in the Troika's strategy to ensure economic recovery.

Conversely, adjustment programmes that are less tightly controlled by the technocratic policy makers of the Troika leave well-known political dynamics of re-election-seeking officials unconstrained. In other words, reforms implemented by elected officials are likely to reflect to some degree their desire to cater to important voter groups in order to minimise electoral punishment. In this regard, the established literature offers two possible patterns of how such policy makers would distribute the adjustment burden when faced with fiscal consolidation pressures that are relevant to the analysis at hand: The first posits that governments design reforms in a way that protects their own voters from the most adverse effects (Walter 2016). The second, resting on a Downsian understanding of democracy, hypothesises that governments will seek to protect the median voter, i.e. voters in the middle of the income distribution. The median voter theorem postulates that this is because the middle of the income distribution constitutes the decisive voters around which powerful electoral coalitions form with which office-seeking policy makers seek to gain favours (Downs 1957; Iversen and Soskice 2006).

Using data produced with tax-benefit microsimulation tool EUROMOD, this paper finds that the distributive effects of the reforms in the Greek EAPs match the expectations associated with a Troika-controlled programme more closely: Throughout the adjustment process, the lowest income group remained mostly shielded from reform-induced income losses. In fact, the paper presents evidence that those in the lowest income groups in Greece were compensated through the expansion of benefits and thus saw relative income increases compared to the pre-EAP tax-benefit system. In Portugal, the observed distributive effects suggest that the programme was less tightly controlled by the Troika, as it was middle income groups that were relatively shielded from benefit cuts and tax increases while both lower and higher income groups registered the largest income losses. A closer analysis of the observed effects further yields that there is no statistically significant correlation between support for the government and the degree to which voters were shielded from adverse effects of the reforms. This suggests that the Portuguese programme was both less in line with the preferences of the Troika, and that the guiding principle of the reforms was median voter alignment rather than direct voter responsiveness.

In the second part of the analysis, the paper presents evidence for the degree to which each programme was controlled either by the Troika or the domestic government. The evidence corroborates that the Greek adjustment process was closely controlled by the Troika. Moreover, there is evidence suggesting that the Troika only took stronger control over the Greek reform process from 2012 onwards after an initially more hands-off approach in the first two years – which is congruous with the observed distributive effects, as they show a marked upward trend of incomes in lower deciles after the second year of the reform process. Conversely, the Portuguese government retained relatively more control over the reform process, which is evidenced by the frequent and successful alterations of Troika reform prescriptions prior to their implementation. The early return of the country to the long-term bond market contributed to restricting the control of the Troika over the reform process by limiting the leverage represented by the prospect of withholding bailout funds.

The paper makes three contributions: Firstly, it provides annual data on the direct distributive effects of the austerity measures implemented as part of the EAPs in the Eurozone crisis. The data are decomposed by income decile allowing a more fine-grained analysis than the use of aggregate indicators such as the Gini coefficient. Secondly, it contributes to our understanding of the preferences of different policy makers regarding the redistribution of income.

On the one hand, it thus formulates the argument that austerity measures controlled by technocratic policy makers have more room for progressive reforms than those implemented by elected policy makers. On the other hand, it contributes to the literature on the median voter and the political power of the middle class (Iversen and Soskice 2019). This also advances the argument that the democratic processes involved in the preference formation of elected policy makers may in fact present an obstacle to progressive reforms. Thirdly, it enhances our understanding of the economic adjustment processes in the Eurozone, particularly with regard to the interaction of the Troika and domestic governments by showing that the control of the Troika over the reform process varies substantially across countries and over time.

2.2 Literature review

2.2.1 The political economy of adjustment: austerity as a trigger for distributive conflict in the Eurozone

When faced with a balance of payment crisis, countries can typically decide between broadly two[23] different strategies to solve this crisis (Webb 1991): Countries can opt for external or internal adjustment (or a combination of the two). External adjustment refers to restoring competitiveness by devaluating the currency and thus boosting exports and limiting imports and through that the outflow of capital. Internal adjustment refers to restoring competitiveness by means of policies aimed at reducing prices domestically, in practice often through a combination of structural reforms and fiscal consolidation measures. Both options are painful and therefore unattractive for governments: external adjustment leads to higher prices on imports, which hurts consumers and firms,

[23] This excludes various forms of financing budget deficits that do not address underlying macroeconomic or structural problems and thus are only appropriate for liquidity crises but not solvency crises.

particularly in heavily import-dependent economies (Frieden 2014). At the same time, the debt burden increases for debt denominated in foreign currencies (Walter 2013). Internal adjustment on the other hand is costly because it inevitably causes conflicts over how the burden of spending cuts, tax increases, and the often painful structural reforms that ordinarily involve policies for flexibilising labour markets are distributed among different groups.

Faced with this difficult decision, policymakers tend to choose the least costly strategy, based on their country's individual vulnerability profile (Walter 2013). However, membership of a currency union such as the Eurozone significantly constrains countries in this choice: having relinquished control over their currency to the ECB, Eurozone member states had virtually no means of external adjustment without leaving the currency union, which in turn would have likely triggered an exit from the EU altogether. As this increases the costs of external adjustment exponentially, policy makers in the debtor countries were effectively left with internal adjustment as the only option. Similarly, in the language of bargaining games (Cline 1995; Eichengreen 1996; Frieden 2015; Simmons 1994), the high costs associated with an exit from the Eurozone on the part of debtor countries, which a default on public debt would have likely resulted in, left creditor countries with virtually all the bargaining power. This allowed creditors to insist on repayments of the debt and the implementation of internal adjustment measures in the debtor countries to achieve this aim. The unique institutional setup or 'design failures' of the Economic and Monetary Union (De Grauwe 2013), such as the absence of a lender of last resort central bank to calm markets, exacerbated this (see also De Grauwe and Ji 2015; Iversen and Soskice 2018).

Having established that Eurozone member states were left with internal adjustment and immediate austerity measures as the only policy option available to them, the following section outlines how policy makers typically solve the distributional conflicts arising from the need to implement structural reforms, cut public expenditure, and increase taxes.

2.2.2 Distributive conflicts: elected governments

The issue of redistribution is a key competence of governments and as such one of the most central topics in the study of democracy. We can therefore build on a vast literature on the politics of redistribution as a basis for the propositions formulated in this paper regarding the distributive effects of the austerity measures observable in the Eurozone crisis. There are a number of different accounts in the literature on the preferences of elected policy makers regarding the redistribution of income, particularly when faced with internal adjustment pressures. However, they are united in the key assumption that officials will go with whichever option is least costly to them in terms of electoral punishment. The reform process thus becomes a deeply political issue as governments aim to shield those groups from the most adverse effects of the reforms that they perceive as decisive for their re-election or ability to govern successfully (see also Hibbs 1977; Garrett 1998). The central question in this context, therefore, is which groups exactly are the ones that governments perceive as decisive and would thus aim to shield in the painful economic adjustment process.

One highly influential strand in the literature on redistribution is based on the median voter theorem (Downs 1957), which, in simple terms, stipulates that redistribution is determined by the hypothetical voter in the middle of the income distribution. Based on a right-skewed distribution of pre-fisc incomes, the median voter has an income below the mean and will push governments for ever more redistribution from higher to lower incomes until equilibrium is reached at the point where the costs of work disincentives through taxation are on par with the benefits from higher levels of redistribution. Romer (1975) and

Meltzer and Richard (1981) show that the median voter theorem can thus be applied to explain increasing levels of redistribution through taxes and benefits.

Of course, it should be noted that the model operates under several restrictive assumptions[24], one of which is that the logic only applies to majoritarian electoral systems: In proportional representation (PR) systems, on the other hand, coalitions can technically form regardless of representing the median voter. Iversen and Soskice (2006) make an important contribution adding the dimension of different electoral systems. Their findings, however, show convincingly that PR systems in fact tend to produce higher levels of redistribution. This is because it is more attractive for middle income groups to form electoral coalitions with lower income groups rather than higher income groups, which in turn favours centre-left governments that tend to redistribute more. In the same vein, Huber and Powell (1994) show that whilst Majoritarian systems directly produce governments that are committed to policies that correspond with the preferences of the median voter, legislative bargaining in PR systems ultimately too results in policies that are closely aligned with median voter preferences (see also Lijphart 2004). Therefore, although the original logic of the median voter theorem applies only to Majoritarian systems, we can ascertain that through the formation of electoral coalitions and the process of legislative bargaining, the policies produced in PR systems are as or even more closely aligned with the preferences of the median voter.

At this point, it is worth discussing a major implication of this argument for our understanding of how democracies work that is often overlooked or reduced to a footnote in the vast literature on redistribution: While there is strong evidence for democratic processes leading to more redistribution, thus keeping excessive inequality at bay if measured in aggregate terms, this logic does not

[24] For a more detailed discussion see Iversen and Goplerud (2018).

dictate that lower income groups specifically benefit in this system if we decompose our measures of inequality. Indeed, all that the above-cited literature predicts is that the groups closest to the middle of the income distribution are politically the most powerful. Iversen and Soskice in their recent work *Democracy and Prosperity* call this the 'fundamental equality of democracy' arguing:

> "the winners from advanced economies are typically the decisive voters – they choose policies to re- and in some measure also predistribute; they may or may not make those choices to compensate the losers; and in particular they may choose not to compensate the poor. [...] the essence of democracy is not redistribution or equality, as so commonly assumed, but the advancement of middle class interests." (Iversen and Soskice 2019, 19f.)

An alternative interpretation of the voter responsiveness argument is based on the notion of economic voting, i.e. that voters reward governments for positive economic conditions (Anderson 2000; Lewis-Beck and Stegmaier 2007; Powell and Whitten 1993). When applied to the issue of internal adjustment and how governments solve distributive conflicts arising from it, this argument stipulates the following: it is not the position on the income distribution that is relevant for whether governments choose to protect certain voter groups, but whether or not they voted for the incumbent government. In other words, governments care less about the potential importance of voters denoted by how close they are to the hypothetical median voter and more about whether or not they have voted for the current government, assuming that they would reward the government for protecting them from potential adverse economic effects (such as painful reforms targeting their income) by re-electing them. According to this interpretation, when faced with internal adjustment pressures governments prefer putting the bulk of the adjustment burden on non-voters or opposition-voters rather than their own voters. Indeed, Walter shows that this is true for economic adjustment processes in the Eurozone after the GFC, where voters of the government fared better than opposition- and non-voters in Estonia, Hungary, the Czech Republic and Poland (Walter 2016).

2.2.3 Distributive conflicts: non-majoritarian institutions

Whilst re-election-seeking policy makers in one way or another implement policies that cater to certain voter groups, this logic does not apply in the same way to unelected non-majoritarian institutions as their incentives are markedly different. In the absence of voters pressuring policy makers in non-majoritarian institutions to adopt certain redistributive policies, their policy objectives are driven more by long-term goals the realisation of which in turn rests on ideas regarding the ideal design of economic policies.

For the case of the Troika, these ideas can vary between the different institutions. For instance, the IMF's primary objective in their involvement with domestic politics is clearly to achieve long-term economic growth by prescribing fiscal and structural reforms (Clift 2018). The primary policy objectives of the European Commission are more complex and less narrowly defined than those of the IMF. However, it is clear that the European Commission, whilst generally being a guardian of the Treaties, is also both an agent of the member states (Hawkins et al. 2006) and an agenda setter in her own right (Schmidt 2000). As such, the Commission is committed to driving forward the European project and achieving deeper integration (see also Hooghe 2001). Conversely, the ECB, as the third member of the Troika, has an extremely narrow mandate, its prime objective being ensuring price stability (De Grauwe 2018). However, all three institutions in their function as members of the Troika are also agents of creditor countries in the particular context of the Eurozone crisis. As such, all three institutions were committed to achieving economic recovery in the debtor countries in order to ensure that they would be able to repay the loans provided by the IMF and EU member states.

What can be deduced from these diverse policy objectives regarding the institutions' preferences on inequality and redistribution? On the one hand, one could readily assume that inequality is not a central issue for these institutions, particularly because of the absence of electoral pressures forcing policy makers to make redistribution a policy priority. In fact, there is extensive evidence that throughout the second half of the 20th century, intervention from the IMF in countries with supranationally administered economic adjustment programmes was associated with rising levels of inequality (Ball et al. 2013; Furceri and Loungani 2016; Woo et al. 2013). This is in line with the then-prevailing orthodoxy in the economic discipline built around the principles of the Washington Consensus (Williamson 1990). Following this, the IMF mostly advocated for policies predicated on a strong trust in markets and a limited role for governments (Stiglitz 2008). Substantive redistribution for the sake of increasing equality within an economy was clearly of secondary importance, and even viewed as harmful to achieving economic growth due to an alleged trade-off between equality and efficiency (Okun 1975). In fact, any potential efforts to advocate for higher levels of redistribution fell behind the Fund's strong focus on price stability and austerity as necessary preconditions to achieve long-term economic growth (Babb and Buira 2005; Boughton 2001).

However, as demonstrated in greater detail in the previous paper, the Troika institutions, particularly the IMF and the Commission, had an interest in making the EAPs as socially acceptable as possible and to eschew increases in inequality.

For the IMF, this was the result of a longer process of gradual institutional change, partly motivated by lessons drawn from the East Asian crisis of the 1990s (Chwieroth 2009) and partly by the GFC (Clift 2018) triggering a considerable rethinking of the prevailing economic orthodoxy. As a technocratic institution, the IMF is motivated primarily by what is perceived as 'sound economic policy' (Ban 2015; Clift 2018). As such, it followed shifts within the economics profession towards more market-scepticism (see e.g. Auerbach and Gorodnichenko 2012; DeLong et al. 2012) with a growing focus on the issue of economic inequality (Atkinson 1997; 2015; Atkinson, Piketty, and Saez 2011; Cingano 2014; Piketty and Saez 2003; 2014). Internal research by the IMF corroborates both trends in the economic literature (Cottarelli and Jaramillo 2012), emphasising the negative effects of inequality for sustainable long-term economic growth (Berg and Ostry 2011; Ostry, Berg, and Tsangarides 2014).

This is particularly true during recessions and phases of economic adjustment and is based on two important insights: Firstly, in order to be able to implement far-reaching economic reforms ultimately aimed at ensuring economic recovery and a return to economic growth, it is crucial to retain the support of the public and thus to minimise resistance. This in turn necessitates a balanced and equitable design of the reforms that distributes the adjustment burden fairly (Lipton 2013). Secondly, due to lower income households' higher marginal propensity to consume, redistributing towards them results in a more marked boost for aggregate demand and by extension for economic output (Ostry in Clift 2018, 82).

We know from extensive interview evidence that internally this process was consciously driven forward by change-agents such as Dominique Strauss-Kahn, Olivier Blanchard, and Christine Lagarde, who put economic inequality and the social impact of IMF-prescribed reforms at the top of the agenda (Clift 2018). Ultimately, the hierarchical, top-down organisational form of the IMF (Copelovitch 2010; Momani 2007) allowed these ideas to quickly translate into actual policy prescriptions. It is important to note that whilst the shift in the IMF's stance on inequality was substantial, it would be somewhat hasty to describe it as a paradigm shift as theorised by Hall (1993): the IMF's primary objective of achieving economic recovery and long-term growth in the debtor nations remains unchanged. However, excessive levels of inequality are now simply viewed as an impediment to this objective. By extension, more redistributive policies compensating lower income groups were incorporated into the IMF's existing repertoire of instruments constituting 'sound economic policy' to achieve economic adjustment.

The European Commission's preferences regarding inequality and redistribution are less straightforward. However, as outlined in the previous paper, we can infer that on the one hand the Commission had little interest in being associated with regressive economic policy reforms in the member states that punish the weakest members of society. This rests on the notion that the Commission must necessarily derive its democratic legitimacy through its output dimension to compensate for what it lacks in input legitimacy (Beetham and Lord 1998; Hix 2008; Majone 1998; Moravcsik 2002). On the other hand, there is evidence that Commission bureaucrats favour an economic model that incorporates a stronger social dimension, rejecting the more market-oriented model of liberal market economies (Hooghe 2000). Instead, they seek to promote a stronger European social model (Hooghe 2001; Ross 1995). Regressive cuts to the welfare state would seriously undermine this project.

Further to this, there is evidence that EU bureaucrats have recognised that the European social model has come under pressure and that they would prefer a stronger orientation towards policies that ensure greater equity through redistribution (Ross 2011; see also Garand, Parkhurst, and Seoud 1991 for a more general analysis of redistributive preferences of bureaucrats). In this regard one can conceive of the austerity measures in the EAPs as an example of a 'soft spot' that opens up different policy options for agents to choose from and thus achieve institutional change (Mahoney and Thelen 2010). The Eurozone crisis can be taken as an instance where Commission bureaucrats used an opportunity to realise to a certain degree their own preferences regarding inequality and redistribution by incorporating redistributive elements in otherwise harsh austerity programmes in the Eurozone periphery.

The ECB, as the third Troika institution, was arguably the most hawkish of the three and it is the most difficult to gauge its preferences regarding inequality and redistribution. However, despite being a highly independent central bank with a singular focus on price stability, it cannot ignore the implications of fiscal policy for its own objectives. In practice matters of fiscal policy are often as important to central banks as monetary policy as the two are closely linked and interdependent (Ban and Patenaude 2018; Gabor 2016). This is illustrated by the fact that since the GFC central banks' communication on fiscal policy issues has intensified significantly (Allard et al. 2013). With regard to inequality in particular, the ECB has recently begun conducting research into the effects of monetary policy on the distribution of incomes (Ampudia et al. 2018; Lenza and Slacalek 2018) indicating that even central banks are far from impervious to this issue. However, the evidence suggests that this turn in the ECB's attention towards the issue of inequality occurred after the conclusion of the EAPs. In fact, the thesis finds no evidence that the ECB pushed for any one position during the adjustment processes in the Eurozone crisis with regard to the distributive effects of the reforms other than ensuring fiscal prudence.

In conclusion, regardless of whether one assumes a pessimistic view of non-majoritarian institutions in the tradition of Niskanen's self-interested budget-maximisers (Niskanen 1971), or a more optimistic view resting on the notion that unelected bureaucrats have stronger predilections to altruism than persons in other professions or indeed elected officials (Chang 2002; Etzioni 1988), we can conclude the following: Within the confines of the austerity paradigm and without impinging upon the need for fiscal adjustment, the Troika institutions aimed to make the EAPs as socially palatable as possible. For the IMF, this was a result of gradual institutional change and a shifting interpretation of what constituted 'sound economic policy' with increasing levels of inequality now being seen as a threat to sustainable economic growth. For the European Commission, being associated with regressive reform programmes was seen as a threat to the European integration project, and incorporating elements of redistribution and compensation for the most vulnerable members of society constituted a way for Commission bureaucrats to mould the EAPs according to their own preferences. Moreover, as is evidenced in the EAP-related documents, both institutions seem to view a progressive design of the overall painful reforms as instrumental to maintain public support and thus to ensure the successful conclusion of the programmes. It is important to note here that the above applies to the area of fiscal policy, whilst e.g. labour market reforms follow a somewhat different logic as winners and losers from reforms are less obvious and effects less immediately visible as with fiscal reforms.

2.2.4 Research question and hypotheses

This paper explains the variation in the distributive effects of austerity measures in different countries. The literature showcases that elected policy makers and Troika technocrats have substantially different motivations with respect to how they choose to distribute the reform burden in times of economic adjustment. Elected governments are in one way or another responsive to the interests of important voter groups in pursuit of securing their re-election. Depending on different strands in the literature, these decisive voters are either the governments' own voters, or the median voter. Troika technocrats on the other hand seem unconstrained by the need to cater to certain voter groups' interests, aside from the general aim of preserving a basic level of public support for their reform prescriptions.

We also know from the literature on economic adjustment and balance of payment crises that the nature of adjustment strategies is not predetermined or necessarily dictated by one party only, i.e. either the creditor side or the debtor side. Instead, this depends on which side wields most of the bargaining power. Historically, these dynamics have played out very differently: In the 1930s debt crisis for instance, debtors held all the bargaining power due to the very credible threat of defaulting and the low costs associated with a possible default after the breakdown of international financial markets (Eichengreen 1996; Simmons 1994; Frieden 2015). During the 1980s recession on the other hand, financial markets remained intact, thus making a default much more costly and painful to debtors and leaving creditors with most of the bargaining power (Cline 1995).

For the case of the Eurozone EAPs this suggests that different degrees of influence over the reforms process by either the domestic governments or the Troika are possible. Therefore, who decides on the specificities of the reform measures' design depends on each country's bargaining power vis-à-vis the Troika – whether it is ultimately the elected officials of the domestic governments or the unelected technocrats of the Troika institutions. Importantly, this should not be conceived of as a dichotomous variable implying either full control over the reforms exercised by either the Troika or the domestic government. Instead, the operationalisation of this variable used in this paper is on a continuous spectrum, accommodating possible changes over time. In other words, the exact degree of control over the reform process exercised by the Troika can vary both across countries and over time within countries.

Combining these insights, the paper hypothesises that the distributive effects of the reforms depend crucially on where the locus of decision-making power lies, i.e. whether the reform process is more strongly controlled by either the

Troika or the domestic governments. Specifically, the following hypotheses are derived regarding the distributive effects of the EAP reforms depending on who is in charge of the programme:

> *H_1:* Programmes that are more tightly controlled by the Troika display a stronger focus on redistribution towards lower income groups.

As the literature is more ambiguous on programmes that are mainly controlled by the domestic government and its elected officials, two competing hypotheses are offered:

> *H_2:* Government-controlled programmes will shield government voters from the most adverse effects of the reforms, distributing the adjustment burden towards opposition- or non-voters.

> *H_3:* Government-controlled programmes will seek to protect the decisive voters in the middle of the income distribution due to their higher potential electoral importance because of their ability to form powerful electoral coalitions.

2.3 Research design

2.3.1 Approach

The aim of this paper is to test for and explain the variation in the distributive effects of the Economic Adjustment Programmes across countries. In doing so, the paper is less focused on the effects of the reforms in terms of aggregate measures of inequality but more on the effects on different income groups specifically. Thus, rather than uncovering how inequality has developed more generally as a result of the reforms, the aim here is to pinpoint which groups bore the bulk of the adjustment burden.

As the reforms almost inevitably involved the reduction of some incomes in order to achieve fiscal consolidation, we are thus able to describe and explain in greater detail how the distributive conflicts arising from adjustment pressures have played out. Crucially, this in turn allows us to infer whether a programme is more likely to have been controlled by the Troika or by the domestic government due to the different preferences regarding the redistribution of income. Following from this, for programmes whose distributive effects match more closely the preferences of either the Troika or the domestic government, the paper scrutinises additional evidence to test whether there are signs of stronger control over the reform process by one or the other. Where the domestic government is found to have retained stronger control over the reform process the paper tests different hypotheses regarding the responsiveness to certain voter groups in the government's design of the reforms.

2.3.2 Case study design

I construct a comparative case study of Greece and Portugal in a *Most Similar Systems Design* (*MSSD,* see Seawright and Gerring (2008) for a detailed discussion of MSSD and other case study designs). The dependent variable I am interested in explaining is the variation in the progressivity of the EAPs in question, which is measured by how the burden of the adjustment process is distributed across different income quantiles. A more progressive programme will seek to protect lower incomes, distributing the bulk of the adjustment burden towards higher income groups. Importantly, I use the term 'progressive' in a narrow sense referring only to the way in which the adjustment burden is distributed among different income groups, whilst we know from the previous paper that, in aggregate terms (e.g. if measured by the Gini coefficient), both the Greek and the Portuguese EAPs were progressive in the broader sense that they lowered the overall level of inequality vis-à-vis the tax-benefit system in place prior to the reforms. The crucial independent variable the paper tests in terms of its explanatory power for the variation in the progressivity of the EAPs is the degree of Troika involvement, as the paper has shown that policy objectives of the Troika institutions are different from those of elected governments, suggesting that Troika-controlled programmes would reflect more strongly these institutions' preferences regarding inequality and redistribution.

The remainder of this section substantiates that Greece and Portugal are indeed reasonable cases for an MSSD, presenting evidence that (1) both countries are sufficiently comparable along a number of other independent variables and thus can justifiably be labelled as most similar systems, and (2) why potential other independent variables on which the cases differ are inadequate in explaining the variation in the outcome. Firstly, Greece and Portugal are two similar cases with regard to a number of both general demographic, institutional, and economic factors, as well as more specifically regarding the determinants of fiscal consolidation. They are of comparable size, both in population and economic activity; in their current form they are both young democracies that emerged from autocratic regimes in the 1970s; and they became part of European Communities in the 1980s as part of the Mediterranean enlargement and joined the Economic and Monetary Union in 2000 and 1998 respectively. Especially compared with other EU member states both economies are heavily reliant on small and micro businesses, many of which operate in the tourism industry (European Commission 2018a, 2018b), suggesting that both countries should be hit in a similar fashion by economic shocks and follow broadly similar strategies of economic adjustment.

Aside from these more general parallels, both countries are comparable with regard to factors more closely related to determining the exact nature and design of the Economic Adjustment Programmes (Zartaloudis 2014). The argument here is that pressure to consolidate public budgets, in essence only achievable by cutting government expenditure or increasing revenues, inevitably impacts how the welfare state redistributes incomes through taxes and benefits. An MSSD is thus only sensible if the countries in question are similar with regard to how they tax and spend. We know from the comparative welfare state literature (Esping-Andersen 1990; Hemerijck 2013) that both Greece and Portugal display marked similarities in this regard and can in fact both be classified under the Southern European Model of welfare (Ferrera 1996; 2005; Rhodes 1996). Furthermore, both countries belong to the same 'Mediterranean variant' of 'social systems of innovation and production' (Amable 2003).

Zooming in more closely, the exact composition of welfare spending adds another facet to which form fiscal adjustment is likely to take. Breunig and Busemeyer (2012) show that, during phases of fiscal consolidation, entitlement spending such as unemployment benefits and pensions is much less likely to be retrenched than discretionary spending such as public investment (see also Clayton and Pontusson 1998). This rests on the notion that governments will seek to take the path of least resistance, which in this case means avoiding cuts in entitlement spending as this would require the backing of a parliamentary majority, as well as creating more obvious and concentrated losers that would protest against this form of retrenchment more effectively (see also Pierson 1994, 2001). By contrast, the political costs for governments associated with cutting back on discretionary spending are rather low whilst the benefits in terms of fiscal consolidation are substantial and immediate.

An analysis of the composition of public spending with regard to entitlement spending and investment respectively yields the following: At the onset of the sovereign debt crisis (2009 for Greece, 2010 for Portugal), entitlement spending taken as the sum of spending on pensions and unemployment benefits was at 12.1 per cent of GDP in Greece (pensions: 11.2; unemployment: 0.9) and 11.5 in Portugal (pensions: 10.3; unemployment: 1.2; see OECD 2019). Public investment, taken as government gross fixed capital formation (Keman 2010), was at 5.7 per cent of GDP in Greece and 5.3 in Portugal (Eurostat 2019a). Given these similarities in the composition of public spending, fiscal consolidation measures should take a similar form in both countries.

Further to this, electoral institutions briefly need to be addressed here as they typically play an important role in determining patterns of public spending and by extension also its retrenchment (Iversen and Soskice 2006; Persson and Tabellini 2004). Whilst majoritarian systems favour targeted types of spending, PR systems tend to generate more encompassing benefits with broad constituencies (see also Beramendi et al. 2015). Faced with fiscal consolidation pressures, it is therefore reasonable to expect governments in majoritarian systems to avoid cuts to discretionary spending which can be used to gain political influence in important areas through geographic targeting. Governments in PR systems on the other hand will seek to avoid cuts in entitlement spending due to closer linkages between them and their constituencies (Breunig and Busemeyer 2012). For the purpose of the analysis at hand we can consider both Greece and Portugal as PR systems: Although the Greek electoral system incorporates a majority bonus of 50 additional seats to the party winning the relative majority, the fundamental logic of how electoral systems affect the way in which governments in PR systems tend to design austerity measures is not impaired by the majority bonus as it has little bearing on the linkages between legislators and broader national constituencies. The lack of variation between Greece and Portugal along this variable suggests that, in the case at hand, electoral institutions cannot explain the variation in the distributive effects of the EAPs.

Next to these institutional factors, the likely design and by extension the distributional impact of austerity measures is ultimately a partisan issue. It is well-known that parts of cross-country variations in levels of inequality and redistribution can be traced back to government partisanship (Boix 1998; Bradley et al. 2003; Cusack, Iversen, and Rehm 2006). We also know that austerity per se does not necessarily lead to increases in inequality through cuts in benefits for lower incomes. In fact, austerity can be inequality-reducing if expenditure is cut by limiting the access to benefits for higher income groups or introducing certain forms of means-testing, whilst leaving benefits for lower income groups intact or even expanding their coverage (see also Alesina, Favero, and Giavazzi 2019). This opens up room for manoeuvre for governments to distribute the adjustment burden according to their partisan preferences.

Combining these two insights, it is reasonable to expect that in choosing the exact design of austerity measures, centre-left parties are more concerned with austerity-induced increases in inequality than centre-right parties. Indeed, recent research presents evidence that austerity measures implemented by Social Democratic parties tend to be anchored in distinctly New Keynesian economic ideas with a strong emphasis on delivering equality through redistribution and social investment while realising the general goal of fiscal consolidation (Bremer and McDaniel 2019). Based on this, we can expect austerity measures implemented by centre-left governments to be more progressive than those implemented by centre-right governments. Both Greece

(PASOK) and Portugal (Socialist Party) were governed by centre-left parties at the onset of the sovereign debt crisis. The Portuguese and the first Greek EAPs were thus negotiated between the Troika and centre-left parties, suggesting that the reforms in their original form should display substantial similarities.

However, the Portuguese socialist government was replaced in 2011 by a centre-right coalition under Prime Minister Coelho and the Social Democratic Party[25] that oversaw the largest part of the adjustment process. Thus, the actual implementation of the reforms was left to a centre-right government, which could have altered the reforms according to their preferences. The political landscape of Greece shifted more frequently and dramatically and saw a number of different governments during the adjustment process following Papandreou's PASOK government, ranging from caretaker governments to a New Democracy-PASOK grand coalition with changing junior partners and finally two coalition governments under Prime Minister Tsipras and the far-left SYRIZA. Therefore, whilst the reform measures were indeed initially negotiated by centre-left governments in both Greece and Portugal, the two countries become less comparable throughout the adjustment process. Partisanship is therefore a possible explainer for any observed variation in the distributive effects of the EAPs and as such will be addressed in the empirical section of this paper.

Lastly, both Greece and Portugal were hit by the sovereign debt crisis in similar fashion. Instead of hitting through the banking sectors as it did in countries like Ireland, the crisis in Greece and Portugal laid bare deeper structural weaknesses that contributed to government deficits soaring (Armingeon and

[25] Despite its name, the Portuguese Social Democratic Party of today can be classified as a centre-right liberal-conservative party and is a member of the conservative European People's Party in the European Parliament.

Baccaro 2012). Nevertheless, the crisis in Greece was ultimately much deeper with higher government deficits and public debt and a greater reduction in economic output compared to Portugal. This was facilitated by years of misreporting data on public finances by the Greek authorities, which hid the true depth of the financial difficulties the country had been in for some years prior to 2009 (De Grauwe 2013).

Overall, this review shows that, firstly, Greece and Portugal are indeed reasonable cases for an MSSD comparative case study as they display sufficient similarities along a number of independent variables that could have a bearing on the distributive effects of the reforms. Secondly, aside from a possible different degree of Troika involvement, which the paper will test for in section 4, the only independent variable along which Greece and Portugal differ and which could thus explain different distributional outcomes is partisanship of the government in power.

2.3.3 Methods and Data

The hypotheses noted in section 2.4 will be tested by first assessing the effects of the reforms that were implemented as part of the EAPs on different income quantiles over time. In a second step the observed distributive effects are analysed according to whether they match either of the three redistributive patterns that the hypotheses rest on: Programmes that shield lower income groups are associated with a higher degree of control exercised by the Troika (H_1). Programmes that either shield the voters of the respective government in power (H_2) or middle income groups (H_3) are associated with a higher degree of control exercised by the domestic government and its elected officials. The analysis is augmented in a further step with an assessment of empirical evidence regarding the degree of control exercised by either the Troika or the domestic government. To this end, the Memoranda of Understanding and the regular programme reviews are analysed in order to identify possible changes in the reform strategy that match the preferences of the Troika or the domestic government more closely. Similarly, patterns of conflict between the two involved parties are analysed as well as the impact of these conflicts on the implementation of the reforms.

For the first part of the analysis, it is important to note that in view of the depth of the recession and the increases in unemployment levels in both countries, incomes will inevitably change substantially even without any reforms. It is therefore necessary to isolate the effects of the reforms on incomes. This is done by using microsimulation tools that construct detailed counterfactuals. These counterfactuals allow us to calculate how incomes at the individual or household level would have developed in the absence of any given reform holding all else equal. Comparing these counterfactuals with how incomes actually developed under the reforms allows us to isolate the exact effects of any reform on each income. This paper uses microsimulation tool EUROMOD, which is the most widely used tool for analyses of EU member states, and has been validated on both the micro and macro level and tested in various applications (Bargain 2006; Figari et al. 2012; Sutherland and Figari 2013). EUROMOD uses European Union Statistics on Income and Living Conditions (EU-SILC) microdata, which provides detailed survey data on incomes at both the individual and household level. EU-SILC is available for all years of the adjustment process except for 2018 due to time lags in data collection. The data produced with EUROMOD is used to calculate the effects of the Troika reforms in each year of the adjustment process on disposable incomes at the household level, aggregated as income deciles. The analysis therefore shows which income groups bore the bulk of the adjustment burden and which were shielded or even compensated, thus revealing whether the redistributive patterns of the reforms match more closely the preferences of the Troika or domestic governments.

For the cases where the patterns of the distributive effects match the preferences of elected governments and thus suggest that they were more in control than the Troika, the paper tests the second and third hypotheses. *H_3* can be tested using the same means, i.e. analysing which income groups remained shielded from income reductions observed in the EUROMOD data. The paper tests for *H_2* by testing for a statistically significant correlation between the type of voter (government-, opposition-, or non-voter) and the average change in incomes due to the reforms. For this purpose, the paper uses voting and income data from the European Social Survey (ESS). ESS data show the party for which individuals voted in each election year as well as the party to which they feel closest. Whilst no individual level incomes are provided in the ESS data, incomes are described as the decile of the income distribution each individual is located in. The paper therefore approximates whether voters of the government in power were more shielded from the most adverse reform effects than voters of opposition parties or non-voters by calculating the likelihood and statistical significance of each voter group to be located in a relatively more or less protected income decile.

2.4 Results and discussion

2.4.1 The distributive effects of the reforms in Greece and Portugal

This section presents the data produced with EUROMOD to simulate the effects of the reforms in the EAPs in both Greece and Portugal for the duration of the programmes. The results show the following: Firstly, the effects of the programme in Greece were overall progressive in the sense that the lowest income decile of households was shielded from possible adverse effects of cuts in public expenditure such as unemployment or other benefits (see Figure 15 and Table 4). In fact, households in the lowest income decile seem to have been compensated through changes in the tax-benefit system and are the only income group that saw relative increases in their incomes due to the reforms. At this point it should be stressed that EUROMOD isolates the effects of the reforms and excludes any effects of the recession such as increased unemployment. The income increases in the lowest decile of households are thus to be understood as relative increases vis-à-vis a hypothetical scenario where no reforms would have been implemented. This does not contradict the fact that throughout the Great Recession incomes in Greece have suffered markedly and virtually all income groups are now much worse off than they were before the crisis began. In other words, the lowest decile of households are better off by the percentages noted below only compared with what they would have been without the reforms, leaving all else equal (i.e. the effects of the recession). Whilst the lowest decile saw relative increases in disposable household incomes, all other deciles saw income reductions, albeit in a progressive manner, with the smallest income reductions in the second to fifth deciles and largest reduction in the top decile (see Table 4).

The data on Greece reveal another fact when we consider changes in incomes over time. Whilst disposable household incomes moved downwards more or less in unison in the first years of the adjustment process, there is a break in this trend after 2012. After that point the lowest three deciles saw relative income increases. The new trend was, however, only sustained for the lowest decile, which subsequently saw continuous income increases, whilst incomes for the second and third decile fluctuated for the remainder of the adjustment process, albeit above 2012 levels. This suggests that the distributive effects of the Greek EAPs match the preferences of the technocratic policy makers of the Troika as outlined in section 2.3 and H_1 from 2012 onwards. This in turn suggests that from that point the Troika exercised stronger control over the reforms and their implementation through the domestic government.

The data also shed light on the explanatory power of government partisanship, which was identified as a possible independent variable to explain the programmes' distributive effects along which Greece and Portugal differed throughout the reform process. The data for Greece show, however, that partisanship of the respective governments cannot have had any major bearing on the progressivity of the design of the reforms and by extension their distributive effects. Since 2012 Greece has had five rather different governments: two non-party caretaker governments, one coalition government under the centre-right New Democracy, and two coalition governments under the far-left SYRIZA. Yet, there seems to be little to no variation in the distributive effects of the reforms throughout the remainder of the EAPs since 2012.

There are two possible explanations for this: (1) the Troika indeed seems to have been in control of the reform process and deciding on the exact design of the reforms from 2012, thus rendering government partisanship irrelevant to the reforms' distributive effects (see H_1,); (2) in designing austerity measures governments are driven less by party affiliation than the preferences of certain voter groups (see H_2 and H_3). However, as these preferences are unlikely to have shifted substantially from before and after 2012, the evidence for Greece suggests that the Troika's control over the reform process has the most explanatory power for the observed distributive effects.

Nevertheless, in order to conclusively accept H_1, further evidence of Troika control is necessary. In particular, it is important to assess whether there is indeed evidence for a shift in how the Troika managed the Greek EAPs and whether the degree of control changed throughout the adjustment process and is congruous with the observed distributive effects, in particular the break in the trend in 2012.

Figure 15: percentage change in income due to the reforms in the EAPs, per decile: Greece (cumulative effects 2009-2017; original income=100%)

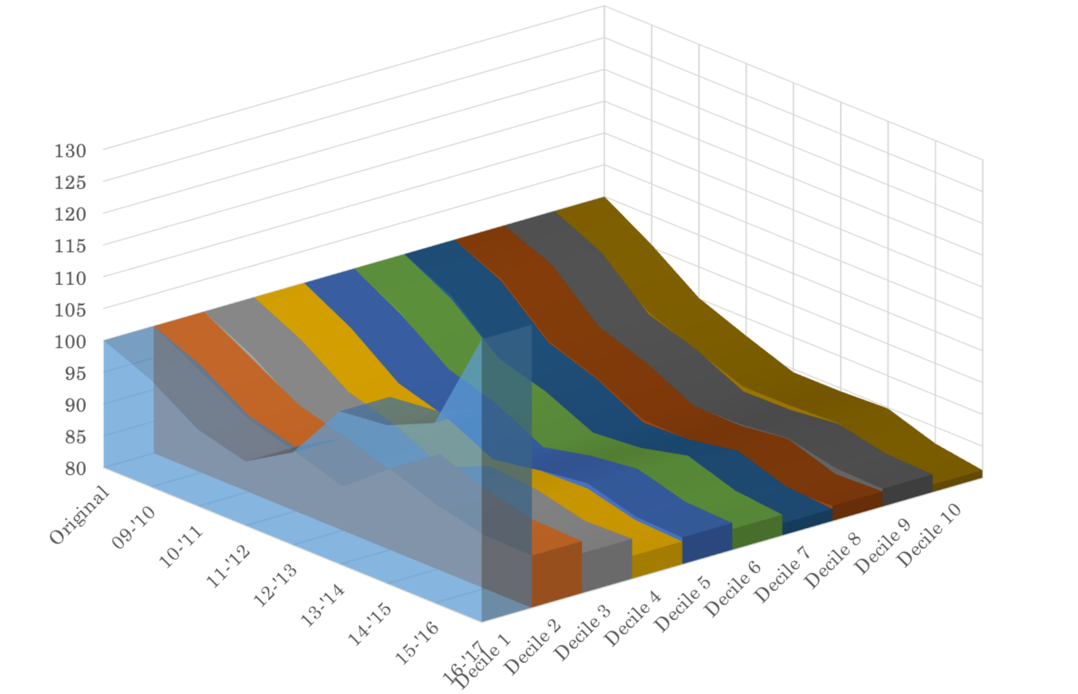


Table 4: percentage change in income due to the reforms in the EAPs, per decile: Greece (yearly effects 2009-2017)

DECILE/YEAR	*'09-'10*	*'10-'11*	*'11-'12*	*'12-'13*	*'13-'14*	*'14-'15*	*'15-'16*	*'16-'17*	*TOTAL*
1	-3.16	-4.77	-1.98	4.45	9.49	0.85	3.40	16.18	24.46
2	-4.24	-4.30	-2.12	-2.43	5.84	-2.70	-1.66	-0.21	-11.80
3	-3.68	-5.13	-2.23	-3.62	3.29	-0.72	-1.80	0.20	-13.69
4	-4.12	-5.60	-2.23	-3.68	1.27	0.23	-1.87	-0.38	-16.37
5	-4.25	-5.51	-2.40	-3.80	1.68	0.97	-2.10	-0.34	-15.75
6	-4.06	-6.30	-2.17	-3.43	0.67	1.81	-2.44	-0.79	-16.70
7	-3.50	-6.65	-2.52	-3.94	0.31	1.32	-2.47	-0.61	-18.07
8	-3.12	-6.76	-2.63	-3.69	-0.14	0.99	-2.50	0.29	-17.58
9	-3.53	-6.69	-2.45	-3.58	0.11	0.89	-1.64	-0.26	-17.16
10	-4.54	-5.34	-2.93	-2.71	0.04	0.34	-2.47	-1.16	-18.78

Sources: Calculations with EUROMOD version H1.0+.

Secondly, the data for Portugal show that, whilst all incomes were reduced as a result of the EAP reforms, incomes in the middle of the income distribution were protected the most from the adverse effects of spending cuts and tax increases (see Figure 16 and Table 5). Households from the third to the sixth decile saw the smallest reductions in disposable income, whilst both the lowest and the highest decile saw the largest reductions. This suggests that (1) the Troika had less control over the Portuguese EAP, as the observed distributive effects do not match their preferences; (2) assuming that the domestic government was indeed in charge of the reform process, it seems to have been primarily interested in protecting the decisive voters in the middle of the income distribution. These points require further testing in two ways.

Firstly, evidence is needed on whether or not the Portuguese government indeed retained more control over the reform process vis-à-vis the Troika. Secondly, the paper needs to test whether there is a statistically significant correlation between those groups that were most protected from reform-induced income reductions and whether or not they voted for the government in power. In the first step, H_1 can be confirmed if it is found that the Troika had little control over the reform process, which would be compatible with their preferences regarding redistribution. The second step of the analysis allows us to discriminate between H_2 and H_3, i.e. whether the government – if found to be the controlling party – was more interested in protecting the median voter, or their own voters regardless of their position on the income distribution.

Overall, it needs to be noted that the magnitude of the income reductions is lower in Portugal than in Greece, with the exception of the first and tenth deciles in Portugal. This is likely due to the worse economic situation of Greece which demanded more severe austerity measures to rein in massive budget deficits.

Figure 16: percentage change in income due to the reforms in the EAPs, per decile: Portugal (cumulative effects 2010-2014; original income=100%)

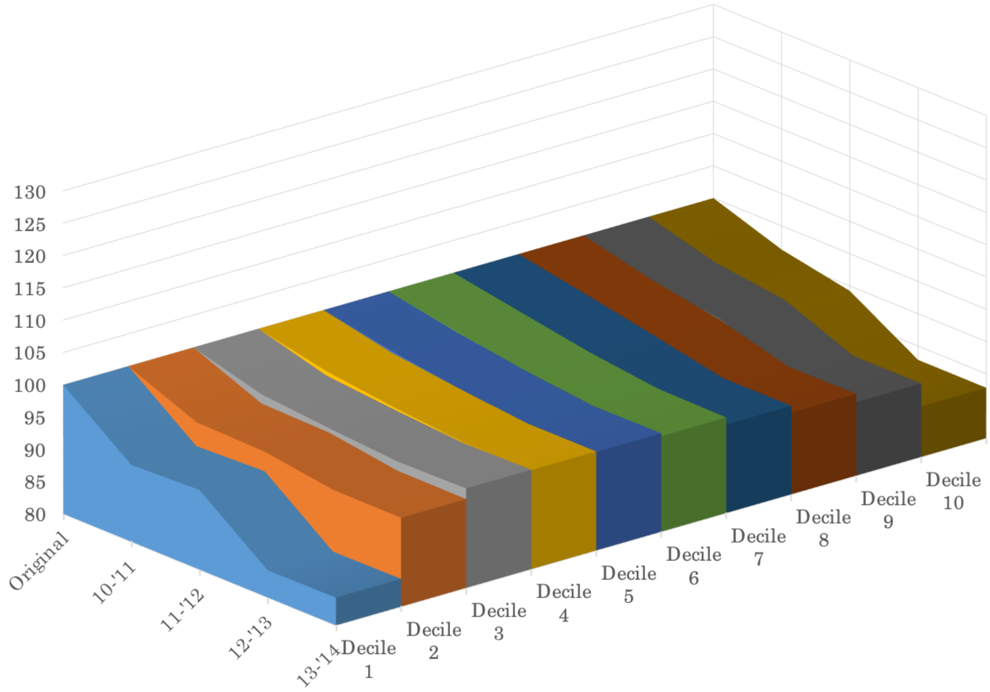


Table 5 percentage change in income due to the reforms in the EAPs, per decile: Portugal (yearly effects 2010-2014)

DECILE/YEAR	*'10-'11*	*'11-'12*	*'12-'13*	*'13-'14*	*TOTAL*
1	-8.08	0.44	-8.11	0.07	-15.67
2	-4.37	-0.24	-1.57	-0.05	-6.22
3	-2.94	-0.99	-0.81	0.16	-4.58
4	-2.29	-1.31	-1.06	0.01	-4.65
5	-1.99	-1.62	-1.19	0.06	-4.73
6	-1.88	-1.84	-1.31	-0.14	-5.18
7	-2.0	-2.08	-2.20	0.01	-6.27
8	-2.55	-1.94	-2.88	0.03	-7.34
9	-2.90	-1.37	-4.33	0.0	-8.61
10	-3.66	-2.10	-6.37	-0.02	-12.16

Sources: Calculations with EUROMOD version H1.0+.

2.4.2 Troika control over the reform process

Assuming that H_1 and either H_2 or H_3 are correct, i.e. that Troika-controlled austerity programmes display different distributive effects than those controlled by domestic governments, the data presented in the previous section would suggest that the Greek EAPs were Troika-controlled and the Portuguese EAP was government-controlled.

This section therefore serves to present evidence for these two operationalisations of the paper's general hypothesis that the distributional effects of economic adjustment programmes are determined by where the locus of decision-making power lies with regard to the specific design of the reform measures. It does so using a two-pronged approach. Firstly, it provides reasons for why the Troika might find it necessary to take stronger control over the reform process in either of the two countries. Secondly, the paper presents empirical evidence as to whether or not the Troika did in fact tighten its grip on the reform process in either Greece or Portugal.

2.4.2.a Reasons for Troika having to exercise more control in Greece than in Portugal

With regard to the former, the following question needs to be answered: Is there evidence for why the Troika would deem it necessary to control the reform process more strongly in Greece than in Portugal? Indeed, there are three reasons for why this would be the case, which will be laid out in detail in the following.

Firstly, Greece and Portugal are different regarding their public administration capacity to implement reforms, particularly when necessitated by external factors such as EU directives. Traditionally, both Greece and Portugal have a rather poor track record in the timely implementation of EU law and have been classified in the literature as members of the 'world of neglect' (Falkner et al. 2005, see also Hartlapp 2005). However, whilst public sector efficiency is low in both countries when compared to other EU member states and particularly those that joined in and before 1995, there are important differences between Greece and Portugal, particularly with regard to the capability to implement reforms (Sotiropoulos 2004; Van de Walle, Van Roosbroek, and Bouckaert 2008). Public sector efficiency in Portugal has in fact been found to be improving (Hartlapp 2005). Greece, on the other hand, has been described as a failing state going into the sovereign debt crisis (Featherstone 2011), with a historically weak implementational strength in the public sector (Sotiropoulos 1993; Spanou 1996) and a political culture characterised by rent-seeking and corruption (Mitsopoulos and Pelagidis 2011).

Here, Afonso et al. provide two important insights for the specific cases of economic adjustment in Greece and Portugal: Firstly, clientelistic linkages are a major factor in determining how successful governments are in implementing austerity measures. The stronger they are, the less willing are governments to agree to fiscal retrenchment, which would limit their own capacity to preserve these linkages by continuing to trade material favours for votes. Secondly, clientelistic linkages are much stronger in Greece than in Portugal (Afonso, Zartaloudis, and Papadopoulos 2015). In fact, there is a long history of parties handing out favours, or 'rousfetia', to voters in Greece (Lyrintzis 1984), which is less the case in Portugal. Governments in Greece should therefore be less willing and prepared to go through with fiscal consolidation measures than those in Portugal.

These issues in Greece have deep historical roots. In fact, a seminal report was authored already in 1952 by Greek economist Kyriakos Varvaressos the purpose of which, in part, was to outline 'pathologies' of the Greek public administration system (1952). Varvaressos cites among some of the key causes of this problem a major organisational mismanagement, including an imbalance of resources and staff apportioned to different arms of the state (ibid.); a legacy of legalistic and formal interpretation of rules and regulations, impeding the quality of public service delivery, flexibility and innovation inside the public sector; and lastly – and arguably most saliently for current purposes – an established tradition of patronage, clientelism, and corruption, including a disregard for meritocratic norms in appointments and promotions.

Greek public sector administration has, furthermore, historically been described as having low institutional capacity, being home to a bloated and malfunctioning apparatus. This is diagnosed cogently in a recent historical evaluation by Makrydemetres et al. (2016) of structural reforms inside Greek government departments:

> The capacity deficit forms more certainly a kind of root cause for maladministration in Greece. [...] The state apparatus, including the size of the personnel approximating 650.000 public employees in the wider public sector and the direct involvement in the economy, is nonetheless very weak and ill-equipped with the requisite professional and strategic capacity and authority to function as an instrument and rational agent for reform and modernisation. Despite the over-inflated size and role of the state bureaucracy, it has failed to acquire distinct and appropriate developmental features which would enable it to act as the engine and driving force for intelligent service and advancement of the society as a whole. Instead of designing and shaping the strategy and the overall policy for rational and long-term development, state bureaucracy in Greece undertook usually the backward and traditional role of satisfying the short term clientelist needs and expectations at the expense of a creative and flexible role and function. Administrative bureaucracy took on a top-heavy and grotesque shape of gargantuan proportions ill-structured and ill-equipped for the complexity of the tasks and the challenges of the process of development and modernisation. (2016, 31 and 35f.)

The limited state capacity thus gives sufficient reason to believe that the Troika felt compelled to micromanage more greatly in terms of oversight of reform implementation. This limited state capacity in Greece is also evidenced by the Troika's apprehension of the stumbling blocks the country would encounter in the process of reform-implementation. The Troika emphasised the separate additional need for large-scale administrative reforms to the bureaucracy, including in basic areas such as introducing a uniform pay-scale for all state employees (Christopolou and Monastiriotis 2014). In its review of the second Economic Adjustment Programme for Greece, the European Commission stressed that bureaucratic overhaul would be crucial to bolstering fiscal reform implementation capacity (European Commission 2012c). The Troika, in fact, acknowledged in retrospect that one of the reasons for Greece's less than stellar reform implementation record had been due to its inadequate administrative capacities (Henning 2017, 123).

Another reason for why the Troika might have deemed it essential to control the reform process more strongly in Greece than in Portugal is the difference in the severity of the crisis between the two countries. This is evidenced by the fact that Portugal had succeeded already in April of 2014 to "forego a precautionary programme and opt instead for a 'clean' exit" (ibid., 130), more than four years prior to Greece. Conversely, Greece faced the prospect of state bankruptcy, defaulting on its debt, and the threat of having to leave the Eurozone and thus likely the EU altogether, which would have likely had a number of severe contagion effects on the rest of the Union.

2.4.2.b Evidence that the Troika *did* exercise more control in Greece than in Portugal

The reasons for the need for more Troika control in Greece as opposed to Portugal are thus clear. In addition to lower general state institutional and administrative capacity with a highly clientelistic historical tradition in Greece, the magnitude of the sovereign debt crisis was also much more severe. In the following, the paper presents evidence for how the Troika did in fact exercise more control in Greece through a much more hands-on approach than in Portugal.

An analysis of the interaction between the Troika and the respective national authorities of Greece and Portugal shows the following. Firstly, it is possible to observe a change over time in how the Troika monitored the reform progress in Greece that is apparent from the various EAP-related documents. Initially following a more hands-off approach, the Troika formulated general fiscal targets for Greece which are laid out in the Memorandum of Understanding of the first EAP for Greece, as well as the first programme reviews. These targets failed to be met in the first two years of the crisis, not least because the salience of fiscal multipliers in the face of large-scale austerity measures during a deep recession had been massively underestimated on the part of the Troika (Blanchard and Leigh 2013).

After this, whether justified or not, the Troika adopted a more hands-on approach monitoring the reform process closely: In addition to formulating general fiscal targets the Troika now required the Greek authorities to outline concrete reform proposals to achieve these targets in each of the regular programme reviews, of which there were two to three per year. In the newly introduced 'medium-term fiscal strategies' the Greek authorities were required to specify in detail particular policy reforms, precise projected savings through each reform, and a timeline for their implementation. The Troika would sign off on the particular reforms laid out in each review and monitored whether they had been implemented by the specified date in the following reviews. The Troika enforced this approach by threatening to withhold funds that the Greek government relied on if the implementation was not in accordance with the reform prescriptions. Similarly, by that point the Troika tolerated practically no pushback against these requirements. This culminated in the 2015 referendum, where the majority of Greek voters spoke out against the continuation of the austerity programmes, which the Troika all but ignored, continuing to push for the unimpeded implementation of the austerity programmes.

Based on the EAP-related documents, the situation in Portugal was different. Troika reform prescriptions remained rather general and revisions of the originally agreed-upon reforms were more frequent as is evidenced in the EAP and the subsequent reviews. This is true both for single reform proposals and the nature of the EAP in its entirety. To illustrate this, Portugal went from an initially expenditure-based programme following the same template as Greece to a much more revenue-based programme prioritising tax increases over spending cuts. This happened against the prescriptions of the Troika who only reluctantly abandoned the expenditure-based approach officially in 2013 towards the end of the EAP. Similarly, several of the reforms that were implemented under the pressure of the Troika were reversed shortly thereafter due to intervention from the Portuguese Constitutional Court which had been invoked in different instances by several parties and the President of the Republic (Magone 2014). At the same time, the speedy return of the country to the long-term debt market in early 2013 constituted a substantial shift in the distribution of bargaining power towards the Portuguese authorities as the country became less dependent on the loans administered by the Troika.

In the following, the paper presents a more granular process-tracing exercise of how the Troika exercised greater control. As a result of the deeper severity of the crisis in Greece and of the real risk of default at the time, a potential 'Grexit' became a real possibility. The country was per definition heavily dependent on the Troika, giving it less freedom to evade the institution's oversight and control. By comparison, the state of affairs were much more subdued in the Portuguese case, as demonstrated by the country's comparatively much more rapid return to the bond markets in 2013, several years before Greece, allowing it to avoid the Troika intrusion and intervention to which Greece was to be exposed (Kowsmann 2013; Hirai and Ainger 2019).

Randall Henning cogently explicates the process of creeping increase in authority and control of the Troika over Greece's handling of the EAPs (2017). In late 2014, it fully came to light that Greece would not be able to follow in the footsteps of other bailout countries Ireland, Portugal and Spain and "exit smoothly" from the programme, instead going into a tailspin (ibid., 203). During the review of Greece's second programme in 2014, it became apparent that a spate of programme benchmarks in structural reforms and labour market policies had not been met, leading to the Troika demanding as a pre-condition for the payout of the next tranche that further pension system reforms and tax raises be implemented. It became apparent that shunning Troika demands would give potential way to Greece defaulting, much to then-Prime Minister Samaras' dismay, who objected to the pre-condition demands and was soon to be replaced by Tsipras (ibid., 203).

The far-reaching arm of Troika control in Greece is observable throughout the tenure of the Tsipras administration. Prime minister Tsipras enjoyed a comfortable electoral victory receiving approximately 36% of the popular vote in January 2015, on the back of a campaign dominated almost entirely by bringing austerity to and end and unshackling Greece from the grips of the Troika. Early in his term as prime minister, Tsipras exclaimed that the "Troika was over", refused to negotiate with creditors, and expelled the Troika missions from Greece in an attempt to kill the EAP agreements (Jacobsen and Fleming 2015). Bitter strife ensued between Athens and the European partners. With Tsipras' mandate from his electoral victory entirely at total odds with the

Troika's priorities, there existed a "bitter atmosphere and yawning gap between the positions of the [Greek] government and the Troika", igniting intensified speculation about Grexit (Henning 2017, 205). A number of factors contributed to Tsipras finally capitulating and giving in to the Troika. First, the Greek government failed to persuade its creditors to scrap the EAP agreements in favour of newly negotiated replacement agreements. Secondly, Tsipras became increasingly estranged in the Euro area and shunned by other member states, which refused to circumvent the Troika or bargain directly with the Greek administration within the setting of the Eurogroup. Lastly, the menacing prospect of potential default became increasingly likely, ultimately forcing the Greek Prime Minister to invite the Troika back onto the scene, agree to relaunch talks with the creditor institutions, and permit technical visits from their staff for data collection purposes again. The only victory in the faceoff with the Troika was the official abandonment of its name, now being referred to simply as the 'Institutions' in official correspondence, but otherwise carrying on with its work as before. The unfolding of events in 2015 will be explicated further in the following.

By 2015, the Troika continued to invoke its control over the reform process through, among other things, holding the payment of the outstanding tranches over the Greek government's head as leverage to induce the country to comply with reforms that had been stipulated in the agreements. One such example of the authority the Troika wielded was that the ECB suspended in January 2015 the purchase of Greek bonds from its quantitative easing programme, and was now in a position where it had power over both the country's banking system's liquidity and thereby the Greek government's access to finance, as well as being in charge of regulating its largest banks with a prospect of assuming further far-reaching supervisory powers over other banks in the nation (Henning 2017, 208f.). Unsurprisingly and inevitably, this reality cornered the Tsipras administration and impelled it to ask its European partners for a programme extension.

The decline in Greek bargaining power and thus the rise in Troika control and influence over the reform implementation process is particularly noticeable in the lead-up to and agreement of the third EAP bailout. The weakening of the Greek side's hand was intensified in the summer of 2015: Greece, on the same day in June 2015, both defaulted on a €1.55 billion debt repayment to the IMF and witnessed the expiration of its second bailout programme, disqualifying it from further funding until it had paid its outstanding arrears (Steinhauser, Dendrinou, and Stamouli 2015). Subsequently, Tsipras announced a national referendum on the future of the EAPs, with the aim of bolstering his bargaining power vis-à-vis Greece's creditors and in the hopes of obtaining concessions, such as a restructuring of or haircut on Greek debt. Despite winning the referendum with a resounding 61% of the population voting "oxi" or "no", the strategy backfired fiercely. Although hoping to use it as leverage with creditors, the triumph of the referendum win would not bear fruit or help create the outcomes Tsipras had envisioned. Trust and rapport between the creditor parties and the Greek government had been frayed arguably beyond repair, which would only spell mounting trouble for the next programme agreement. At the same time the economic conditions in Greece further declined, drastically pushing up the amount of financing that Greece would now need in its third programme (Henning 2017). The impasses in negotiations with the Commission, IMF and ECB culminated in more talk of the threat of 'Grexit' again.

The Troika wished to avoid, at all costs, Grexit. However, it did not take the threat of it off the table, choosing instead to leverage its prospect as a pressure-inducing bargaining chip. This was a tremendous blow to Tsipras' hopes. Even then-Commission President Jean-Claude Juncker came out stating: "I am strongly against Grexit but I can't prevent it if the Greek government is not doing what we expected [...] We have a Grexit scenario prepared in detail" (Sheffield 2015). Then-Council President Donald Tusk concurred, saying: "Our inability to find agreement may lead to the bankruptcy of Greece and the insolvency of its banking system [...] For sure, it will be most painful for the Greek people" (Lewis and Macdonald 2015). What ensued was a departure of the more contrarian finance minister Yanis Varoufakis, who was replaced by Euclid Tsakalotos.

The reach of the Troika's influence over the reforms in Greece is crystallized by the fact that, shortly after the referendum, the Greek government came back to the negotiating table with the Troika and set out a proposal which was almost identical to the offer the Troika had made a short period earlier, one which had been rejected unequivocally by the popular vote in the referendum (Henning 2017, 214). Eventually, the new programme details were a far cry from what Tsipras had been reaching for in his referendum campaign and were settled on very strict terms (ibid., 213). Due to intra-party tumult within Syriza and a rupture with its left-faction, Tsipras announced a snap general election to solidify the democratic legitimacy of the newly agreed programm.

The details and composition of the third EAP are a further exposition of the power and control of the Troika eclipsing the aspirations and wishes of the Greek government, which had begun in earnest towards the end of the first programme. Despite protest and resistance, Tsipras' administration agreed to a comprehensive pension reform, VAT hikes, further expenditure cuts and tax raises to the value of 4% of GDP by 2018. Moreover, they agreed to introduce further labour market and product market reforms, and to restructure the banking system, with the four most important banks in the country being obliged to undergo a new round of stress tests (Henning 2017, 217f.). For the first time, and as a demonstration of the sheer unravelling of the trust creditors had in the prospect of Greece managing to implement the stipulated reforms, these policy measures had to be adopted as prerequisites ahead of the disbursement of the first payment (ibid.). This was yet another signal of the extensive power and control the Troika had over the process in Greece.

In conclusion, it can be said that this constitutes clear proof of the Troika's stricter oversight and tighter control over the EAPs in Greece. Despite Tsipras' urge to expel the Troika from Athens at the start of his incumbency, and his strategy of calling a referendum on the austerity measures, Syriza was unable to escape the fate of previous Greek governments. The Troika's clout in fact only progressively increased over the life cycle of the EAPs beginning in early 2012 based on the document review, as their faith in Greece's capabilities or willingness to execute the policy measures dwindled.

Overall, stronger control over the Greek programme on the part of the Troika may have been warranted due to Greece's lower capacity to follow through on externally prescribed reforms, as evidenced by their poor track record of implementing EU law, as well as the strong clientelistic linkages that have the potential to obstruct the reform progress. Based on the evidence presented in this and the previous section, I infer the following. Firstly, the degree of control over the reform process exercised by the Troika was higher in Greece than in Portugal. Moreover, the evidence shows a shift in the Troika's approach in handling the Greek adjustment, with the Troika tightening its grip on the reform process from 2012 onwards. This clearly matches the distributive effects presented in the previous section in that lower income groups fared better from 2012 onwards and were compensated after initial income losses between the inception of the first EAP and 2012.

This provides evidence in favour of the first hypothesis of the paper: Troika-controlled programmes, as evidenced by the Greek example, indeed display more progressive distributive effects, paying particular attention to the compensation of the lowest income groups. Moreover, the less tightly controlled reform process in Portugal yielded less progressive reforms. However, in order to conclusively accept or reject the first hypothesis, further evidence is needed. The paper presents three cases of clashes between the Troika and the domestic authorities and the distributive effects produced by the accepted or rejected reform prescriptions respectively.

The first example is the pension reform in Greece. Historically, the Greek pension system has been one of the most regressive and unfair systems in Europe (Matsaganis 2020). A number of efforts have been made in the past to reform and modernise the system as well as making it more progressive and less protective of classic insiders such as public sector employees who enjoyed immense privileges under the old system. However, all efforts, most notably those by socialist modernisers around Costas Simitis who served as prime minister between 1996 and 2004, ultimately failed due to large-scale protests in the late 1990s and early 2000s (Featherstone 2005). This failure to reform despite the fact that economic conditions under the high growth rates of the time were more than conducive for welfare state modernization (Ferrera and Hemerijck 2003) illustrates how deeply entrenched and institutionalized inequalities in the Greek tax-benefit system were and how resilient to reform the overall Greek welfare state was.

A comprehensive pension reform, unsurprisingly, was one of the cornerstones of the Greek Economic Adjustment Programmes. The Troika pushed for a proposal that would modernise the pension system modelled after the Scandinavian examples (Matsaganis and Leventi 2011). With introduction of the new system set for 2015, the electoral victory of Syriza put yet another sudden stop to the efforts to modernise the Greek pension system. Adamantly opposed to the austerity measures imposed by the Troika, Syriza repealed the reform and promised to reverse cuts that had already taken place. The Troika pushed back against this and the ultimately introduced reform resembled the original proposal, although with some qualifications that can be traced back to the interference of the Syriza government: The Syriza system reinstated the sharp discrimination between workers with long-term work histories and those without that the reform had sought to do away with. Under the Syriza reform, individuals with less than 15 years of contributions now only qualified for a minimum means-tested national pension of less than €400 per month, i.e. the same as those who never paid into the pension system (Matsaganis 2020). Not only does this provide a clear example of how Troika reforms were more progressive than the policies that national authorities pushed for, it also calls into question once more the validity of the partisanship argument regarding the distributive effects of austerity measures: If the progressivity of the Greek austerity measures could, in fact, be traced back to the partisan colours of the government in power, then the far-left Syriza government should surely not have opposed the more progressive original pension reform.

The second and third example tackle the issue from the other end. Rather than providing instances of the Troika pushing for progressive reforms and overruling, at least to some degree, the domestic authorities, I give two examples of how Troika proposal were entirely reversed through the interference of domestic institutions after implementation in Portugal. This concerns the reversal of the Portuguese pension reform, and the reversal of public sector pay cuts, both of which had clear progressive effects. To illustrate the latter point for the pension reform, Figure 17 shows the distributive effects of changes in the pension system in Portugal in the years 2012-13 and 2013-14. Using EUROMOD following the methodology outlined in Paper 1, the data below show the percentage change in disposable household incomes per decile solely for changes in the pension system. With the introduction of the pension reform following the pressure by the Troika in 2012, incomes were reduced markedly for households at the top end of the income distribution, although there were minor decreases across the board. When the Portuguese courts rejected the measures one year later, triggering an almost complete reversal of the reform, the observed distributive effects point in the opposite direction. However, even this reversal seems to have been regressive beyond going back to the original system given that the bottom income deciles saw no income increases, at all.

Figure 17: Distributive effects of the pension reform per decile

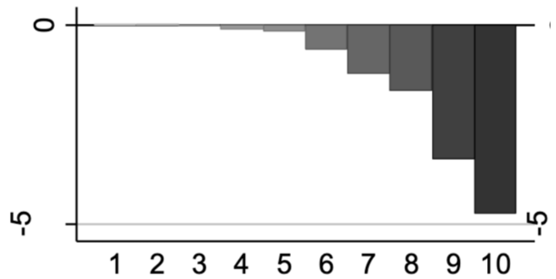
Portugal

Sources: Calculations with EUROMOD version H1.0+.

Similar conclusions can be drawn from the reversal of the public sector pay cuts that had been mandated by the Troika in the same year. Figure 18 below shows the distributive effects of the public sector pay cuts instigated by the Troika, displaying clear progressive effects based on the ordinarily high incomes of public sector employees (see also section 1.4.4.b in Paper 1 of this thesis). Interestingly, the rejection of the public sector pay cuts by the courts also happened based on equality considerations, albeit to somewhat perverse effects considering the distributional outcomes of the court decision. The post programme report of the Troika reads the following:

> "In the view of the Court, the constitutional principle of equality contains the notion of equality of burden sharing which requires that all citizens should contribute in an equal manner to the public burdens according to their ability to pay. As a consequence, fiscal consolidation cannot be based on budgetary measures affecting only civil servants. The Court nevertheless accepted a certain degree of differentiation in treatment between public and private sector employees and accepted, within limits, wage cuts in the public sector due to their exceptional and temporary character in the Budget Laws. However, the suspension of both the holiday and the Christmas allowances for civil servants and pensioners was not considered to be proportional and thus rejected" (European Commission 2016).

Figure 18: Distributive effects of public sector pay cuts in Portugal before reform reversal



Source: Taken from Sutherland et al. 2013.

On this basis, I conclude that there is enough evidence to accept the first hypothesis posited in the paper and that Troika-controlled reforms indeed showed more progressive effects. Secondly, the evidence presented here suggests that, conversely, the Troika had less control over the reform process in Portugal. This broadly matches the hypotheses made regarding the distributive effects of government-controlled austerity programmes in that it is not necessarily lower income groups that are shielded from benefit cuts and tax increases but either those in the middle of the income distribution or those that voted for the incumbent government.

At this point, the argument of the thesis needs to be explicated further. As the Portuguese and Greek cases illustrate, the influence of the Troika on the reforms was, in fact, progressive. However, the less progressive impact of the domestic authorities is not necessarily due to the government directly shielding certain voter groups. In the case of the rejection of the Portuguese pension reforms and public sector pay cuts, it was not the elected government that brought the case to the Portuguese Constitutional Court (although they did push back against the programme in general), but the opposition parties and the President of the Republic (Magone 2014). However, this does not invalidate the argument presented in this thesis. This is because it is necessary to understand policy making as a product of both the demand and supply side of politics, as illustrated in Beramendi et al.'s model of constrained partisanship: Governments tend to follow the will of important voter groups, but they are constrained significantly by for instance the legacies of past policy making rounds, which at that point are institutionalised and enshrined in law (Beramendi et al. 2015; see also Hall 2016). The institutionalised products of past policy making round show the same resilience as all institutions making it difficult to retrench or outright repeal them (Pierson 2001). Nevertheless, the clash that the thesis observes here remains between the technocrats of the Troika, and democratic policy making at the domestic level whether that is through the direct influence of elected governments trying to shield certain groups (as seems to have been the case with the Syriza opposition to the Greek pension reform), or institutional legacies from past policy making rounds shielding these groups in the form of national legislation and their enforcement through the courts (as was the case with the rejection of the Portuguese pension reform and public sector pay cuts, both of which had been progressive).

The next section serves to provide evidence to distinguish whether the domestic government in Portugal sought to shield their own voters or rather voters in the middle of the income distribution.

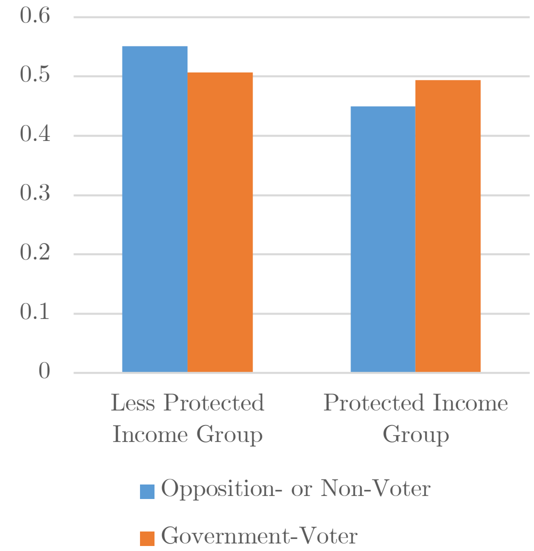
2.4.3 Voter responsiveness

In order to test whether the Portuguese government aimed to protect mainly middle income groups, or their own voters in the reform process, i.e. discriminate between the paper's second and third hypotheses, the paper combines the data produced with EUROMOD with data on partisan preferences of voters from the seventh round of the European Social Survey (ESS) in 2014. The year of the survey is chosen because during the adjustment process, Portugal only had one election at its very beginning. Therefore, voters were left with the same coalition government of the Social Democratic and the People's Party for the great majority of the reform process. At the same time, 2014 marked the official completion of the EAP and is therefore an accurate time point to measure household incomes.

In a first instance, individuals that are eligible to vote are grouped in the three different categories: Voters that voted for the Social Democratic Party or the People's Party (i.e. the two coalition partners of the subsequent government) in the 2011 election are coded as government voters and voters of all other parties as opposition voters. In a small number of cases where individuals stated that they had voted but values were missing in the ESS data with regard to the question who they had voted for, party affiliation was approximated using a question in the survey that asked which party voters felt closest to. Next, those that voted for an opposition party and those that were eligible but did not vote were grouped together as neither of the two groups support the incumbent government and thus warrant similar treatment for the purposes of this study.

In order to gauge whether government voters remained relatively more protected from the adverse effects of the reforms than opposition- or non-voters, each individual is then assigned a value of 0 or 1 depending on whether they are located in one of the more protected income groups or not. Based on the previously presented data produced with EUROMOD, individuals whose disposable household incomes are located in deciles three to six are coded as relatively more protected, with reductions of disposable household income due to the reforms ranging from 4.58 to 5.18 per cent. Individuals whose disposable household income is located in the bottom two or top four deciles are coded as relatively less protected, with income reductions due to the reforms ranging from 6.22 to 15.67 per cent (see Table 5). Next, the likelihood and statistical significance of weighted individuals who voted for the government being located in a relatively more protected income group is calculated. The results show that there is indeed a higher likelihood of government voters being located in a more protected income group (49.36 per cent) vis-à-vis opposition- or non-voters (44.92 per cent; see Figure 19). It is clear, however, that whilst statistically significant, these differences are small.

Figure 19: Likelihood of government-voters (opposition- or non-voters) to belong to protected (not protected) income group: Portugal



Government-Voter	Protected Income Group	
	No	Yes
No	55.08%	44.92%
Yes	50.64%	49.36%
Total	53.98%	46.02%

Pearson:

Uncorrected chi2(1) = 1.3324

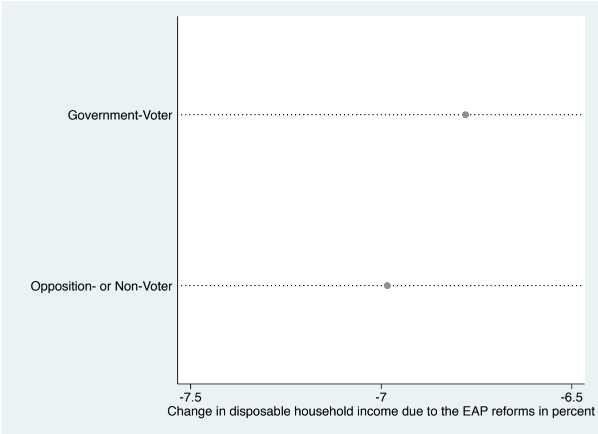
Design-based F(1, 1) = 2.87e+13

P = 0.0000

Sources: Calculations with EUROMOD version H1.0+ and European Social Survey Round 7, 2014.

In fact, in a further step each weighted individual in the ESS data is assigned the corresponding reduction in disposable income based on the data produced with EUROMOD, and the mean income reduction of government voters and opposition- and non-voters is calculated. The results of this exercise show that whilst mean disposable income reductions for government voters are indeed smaller, the difference vis-à-vis mean disposable income reduction of opposition or non-voters is minimal (see Figure 20). Moreover, regressing voter types on the aggregate change of incomes due to the reforms throughout the EAPs, rather than whether different voter types belonged to a relatively more or less protected income group as presented in Figure 19, shows that the difference between government voters and opposition- or non-voters is statistically not significant (see Figure 20).

Figure 20: Average change in disposable household income due to the EAP reforms for government-voters and opposition- or non-voters: Portugal (aggregate effects 2010-2014)



Bivariate Regression:
Mean Change in Income due to the Reforms

Voted for Government	0.166 (-0.264)
Constant	-6.945*** (-0.143)
N	902
r^2	0.001

*** p<0.01, ** p<0.05, * p<0.1

Sources: Calculations with EUROMOD version H1.0+ and European Social Survey Round 7, 2014.

Overall, the results show that whilst there is some evidence of voters of the Portuguese government being more likely to be located in income groups that were relatively more protected, this evidence is weak as the difference between voter groups are practically negligible. Moreover, the statistical significance disappears when voter groups are regressed on average income changes rather than their belonging to certain income groups. On this basis, H_2 can be rejected.

In light of this evidence, with regard to H_3, i.e. governments protecting voters in the middle of the income distribution, the data presented in Table 5 and Figure 11 suggest that H_3 is true. The distributive effects of the Portuguese EAP are such that voters closer to the middle of the income distribution see the lowest income reductions, whilst those at the tails of the income distribution see the highest income reductions. This seems to confirm that governments are responsive to the needs of the median voter and seek to protect these potentially decisive voter groups in order to ensure their re-election. It should be noted, however, that this rests on a somewhat broader definition of the hypothetical median voter as the group of more protected income earners are somewhat to the left of the middle of the income distribution.

2.5 Conclusion

This paper set out to explain the variations in the distributive effects of austerity measures in the Eurozone crisis. The overarching claim made is that the distributive effects of austerity measures are determined by where the locus of power lies, or in other words by who is in charge of administering the adjustment process. Based on the empirical and theoretical contributions of the previous paper, I hypothesised that austerity programmes administered by the unelected technocrats of the Troika should display more progressive effects. They are more likely to protect lower income earners than middle or high income earners. This is not due to an intrinsic interest of the Troika bureaucrats in the issue of inequality, but because reforms that differ from this principle are deemed as contradicting the Troika institutions' understandings of what constitutes sound economic policy for sustainable growth. The IMF views excessive inequality as harmful to economic growth, and the European Commission sees being association with regressive reforms as a threat to the European integration project. The preferences of the ECB regarding fiscal policy are necessarily less clear cut, but the paper finds no evidence in the literature that the ECB should advocate for policies that entail regressive reforms based on e.g. a potential equality-efficiency trade-off, inferring that it is neutral or at least non-resistant toward more progressive policy design.

Elected governments on the other hand follow a different logic in that they are primarily re-election-seeking. As such they are mostly interested in catering to important voter groups such as their own voters or voters located in the middle of the income distribution due to their ability to form powerful electoral coalitions, as opposed to opposition- or non-voters. Austerity programmes that are primarily controlled by elected officials should therefore display distributive effects in accordance with these preferences.

Using data created with tax-benefit microsimulation tool EUROMOD, the paper finds that the Greek EAPs protected those in lower income groups, whilst the Portuguese EAP protected middle income earners. This is generally in line with the expectations formulated at the beginning of the paper regarding a Troika-controlled programme on the one hand, and a government-controlled programme on the other hand. Further analysis yields that the Greek programme was indeed more strongly controlled by the Troika than the Portuguese programme. This is the result of a shift in the Troika's approach regarding the Greek EAPs and a tightening of its grip on the reform process from 2012 onwards. This shift in the Troika's strategy is congruous with a break in the trend observable regarding the distributive effects of the reforms: Whilst the reforms led to uniform reductions in disposable household income across the income distribution prior to 2012, lower income groups and in particular the lowest income decile fared better after that point.

Moreover, with regard to the distributive effects of the Portuguese programme, there is stronger evidence for the government aiming to protect middle income earners than their own voters. This is illustrated on the one hand by middle income groups remaining mostly protected from potential adverse effects of the reforms in Portugal, particular in comparison to households located at either tail of the income distribution, which saw larger income reductions due to the reforms. On the other hand, the statistical evidence for governments seeking to protect their own voters is rather weak suggesting that their position on the income distribution and thus their potential to form powerful electoral coalitions in the future is more important to governments than who they voted for in past elections.

The paper concludes that, in general, variation in the distributive effects of austerity programmes indeed depends on who is in charge of the reform process. It has identified two most similar cases whose only relevant differing variable is the degree to which the reform process was controlled by the Troika as opposed to the national government. It has also found that the concrete observed distributive effects are in line with the expectations associated with such programmes.

One major avenue for further research regards the question of whether the political dynamics illustrated in this paper play out similarly in other policy classes such as labour market reforms, which will be explored in Paper 3.

Paper III

Technocracy inside out. The distributive effects of the Troika reforms through the lens of labour market dualisation.

ABSTRACT

This paper complements and completes the preceding analysis of the effects of the fiscal policy reforms in the previous papers by studying the outcomes of the structural labour market reforms in Greece and Portugal. This is done to uncover whether the consequences of the labour market reforms were similar to those of the fiscal reform measures, i.e. more progressive, in contrast to expectations. The central question the paper answers is whether the stronger involvement of the Troika in Greece led to a different reform trajectory than in Portugal, and how this affected workers in both labour markets. Building on Thelen's *Varieties of Liberalisation* framework and the burgeoning dualisation literature, the paper first assesses the reform trajectories as agreed-upon in the EAPs. Utilising data from the European Commission's LABREF database the paper then evaluates whether the reform prescriptions have been followed in the implementation stage. It finds that reform trajectories indeed diverged, following a wholesale deregulatory path in Greece, and more dualising principles in Portugal. This divergence from the EAPs is corroborated in the ex-post evaluations of the EAPs conducted by the Troika. Using a status-based operationalisation building on Rueda (2007), the paper then evaluates concrete outcomes for workers. It finds that dualisation fell in Greece but persisted in Portugal. Greek labour market insiders thus became more vulnerable while those in Portugal were able to retain some of their privileges. On the other hand, unlike in the case of fiscal reforms, the Troika involvement, while technically equalising, did not incorporate any compensatory elements for vulnerable groups and thus did not contribute to improving employment conditions for labour market outsiders in Greece.

3.1 Introduction

On August 20, 2018, Greece concluded its third Economic Adjustment Programme (EAP), following the largest government bailout in history. Greece was the last of four countries, after Ireland, Portugal and Cyprus, to conclude a comprehensive reform programme largely designed not by elected governments but by technocratic policy-makers. While the majority of accounts in the field of economic and political sciences have focused on assessing whether Greece and the other three programme recipient countries have in fact managed the economic turnaround, much less attention has been paid to the distributional impacts of the reform programmes.

This paper seeks to contribute to closing this gap by providing an analysis of the labour market reforms in Greece and Portugal and their distributional impacts. The analysis rests on a number of insights from the labour market reform and dualisation literature. One key assumption it makes based on this literature is that labour market reforms implemented by office-seeking politicians tend to shield those workers from the most adverse effects of such reforms that constitute important voter groups. Historically, this has led to the cementation of dualised labour markets with a core of protected insiders and a growing number of more insecure outsiders in atypical forms of employment.

Building on the findings of the previous papers of this thesis, this paper further theorises that this prioritisation of already protected groups does not materialise when policy is designed by unelected technocrats, who in turn are mainly governed by their ideas of what constitutes good economic policy. In the field of fiscal policy reform, this was found to have an equalising effect, as evidenced by progressive tax-benefit reforms in the economic adjustment programmes for Greece, which was strongly controlled by the Troika of IMF, European Commission, and ECB.

The paper tests whether the same dynamic can be observed for labour market reforms, which constituted a significant part of the EAPs next to the strict fiscal consolidation measures. It does so by first providing an analysis of the reform trajectories observable in Greece and Portugal. Drawing on Thelen's *Varieties of Liberalisation* framework (2014), the paper analyses the reform prescriptions in the EAPs according to whether they can be classified as wholly deregulatory, i.e. decreasing both the degree of coverage and coordination of labour market regulations, or merely dualising, which pertains to the flexibilisation of employment conditions mainly for labour market outsiders while leaving the protective legislation for labour market insiders intact. This is triangulated with an analysis of the implemented reforms using data from the European Commission's LABREF database.

In a further step, the paper approximates the effects of the reforms for each labour market group by analysing group-specific outcomes for insiders and outsiders throughout the reform process. It does so by employing a widely-used status-based quantitative measure of labour market dualisation (Rueda 2007) as well as tracing individuals throughout various labour market transitions in order to assess whether, during the reform process, different labour market groups have followed different trajectories. In particular, the paper asks whether the reforms implemented in response to the deep recessions in Greece and Portugal have targeted insiders as well as outsiders, or whether the privileges of labour market insiders have remained in place, untouched by the structural reform efforts.

The paper finds that labour markets have indeed become less dualised in Greece, but not in Portugal. This is echoed in the ex-post evaluations of the programmes compiled by the Troika institutions, attesting that labour market dualisation has remained stronger in Portugal, despite the reform efforts. Similarly, an analysis of the reforms based on the European Commission's

LABREF database reveals that those implemented in Greece were by a large majority aimed at lowering the extent of dualisation in the labour market, albeit by attacking insider privileges rather than reregulating labour markets for outsiders, while the evidence is more mixed for Portugal.

These findings are particularly noteworthy as the analysis of the original reform prescriptions in the Memoranda of Understanding (MoU) shows that tackling labour market dualisation through structural reforms was a priority for the Troika, aimed at making labour markets more flexible and efficient through all-out deregulation. However, the programme reviews and the post-programme evaluations of the Troika show that compliance with the reform prescriptions was higher in Greece than in Portugal. This raises the question of what lay behind the lower success of the reform programmes in tackling labour market dualisation in Portugal. The paper finds evidence that this can be attributed to the national authorities pushing back against the Troika's reform prescriptions more effectively in Portugal than in Greece, where domestic authorities were unable to counter the Troika's tight grip on the reform process. The central argument is as follows: As labour market dualisation is more often than not a product of government legislation rather than purely structural factors such as the tertiarisation of the economy, comprehensive labour market reforms designed by technocratic institutions have a greater scope to successfully tackle labour market dualisation. This is because technocratic institutions are not bound by the same political dynamics that led elected governments to pursue policies that cemented labour market dualisation in the first place. It is vital to note in this context that the paper finds that, while labour market inequality indeed decreased throughout the duration of the EAPs in Greece, where the impact of unelected technocrats was largest, this clearly followed a downward trend. In other words, equalisation was achieved by making everybody worse off, but employment conditions for the labour market insiders deteriorated relatively more.

The paper is structured as follows: The first part provides an overview of the existing dualisation literature, outlining the origins of labour market segmentation, as well as presenting a framework to understand and conceptualise different trajectories of labour market reforms, and presenting the case studies. The second part introduces the sources for the paper's empirical analysis, including documents from the Economic Adjustment Programmes and their evaluations, and information on implemented reforms from the European Commission's LABREF database. It also introduces a status-based operationalisation of labour market groups used in this paper. The third part provides the empirical analysis based on the EAPs, LABREF data, and EU-SILC data. The last section of the paper concludes, outlining some limitations and areas of possible future research.

3.2. Theoretical Considerations and Case Selection

3.2.1 The origins of labour market dualisation

Since the late 1970s, workers in advanced capitalist democracies have been subject to growing pressures resulting in increasingly unequal wages and forms of employment, and overall evermore dualised labour markets. Indeed, this is reflected along a number of different facets, all of which constitute different elements of dualisation, including political representation, citizenship, access to benefits, or the degree of job protection (Davidsson and Naczyk 2009). For the purpose of this paper, dualisation is understood as the differences in the vulnerability of workers to the possibility of becoming unemployed. By that definition, insiders are in secure forms of employment with little exposure to unemployment risks or the negative effects associated with it. Outsiders, conversely are employed informally or have little job protection and lower employment rights, thus being overall more exposed to the risk of unemployment (Rueda, Wibbels, and Altamirano 2015).

Parts of this development of growing dualisation across the advanced capitalist democracies can be attributed to structural changes in the economy: In the context of an increasingly integrated world economy, growing competition from low-wage countries has resulted in the displacement of low-skilled workers in advanced economies (Rodrik 1998). By a similar logic, shifts from an industrialised to an increasingly tertiarised economy in the advanced nations have led to growingly unequal forms of employment, as well-paid and well-protected jobs in the highly organised industrial sector have been displaced in favour of less organised employment in the service sector (Iversen and Cusack 2000; Iversen and Wren 1998). This trend was reinforced by sizeable increases in the share of female labour market participation, both as female workers tend to work largely in the service sector (Oesch 2006), and are generally more likely to interrupt their professional careers in order to tend to their families than men (Estévez-Abe 2005). Furthermore, one strand of the literature argues that technological change has led to displacement, particularly in the case of low-skilled and/or routine workers (Autor, Levy, and Murnane 2003; Autor, Katz, and Kearney 2006).

At the same time, these structural changes in the economy have caused and been accompanied by growing pressures on the welfare state, thus limiting its capacity to mitigate adverse effects of structural changes on workers (Pierson 2001). This development was arguably more pronounced for member states of the European Union, with European integration contributing to national governments being increasingly limited by e.g. the fiscal rules of the Stability and Growth Pact (Hemerijck and Ferrera 2003). The latter was exacerbated further through increased tax competition stemming from the internationalisation of financial markets and thus growingly mobile capital (Scharpf 1991).

However, there is consensus in the literature that while such structural pressures do indeed contribute to the deterioration of employment conditions, this has not been the case across the board. In other words, labour markets have become more dualised, with some workers becoming increasingly exposed to the above-described pressures and at the same time less protected by the welfare state (Palier 2010), while other workers have retained more favourable employment conditions. One key insight from the dualisation literature in this regard is that the growing divide between labour market insiders and outsiders is not exclusively brought about "naturally" by the above-described structural factors but is more often than not the direct product of political processes (Emmenegger et al. 2012).

This is because preferences regarding labour market regulation are markedly different for insiders and outsiders: Labour market insiders favour stricter employment protection legislation, which to some degree shields them from job loss by minimising labour turnover as well as improving their bargaining position vis-à-vis employers (Emmenegger 2009). At the same time, such legislation constitutes higher entry barriers for labour market outsiders, such as temporary workers or the unemployed (Saint-Paul 2002), thus translating into diametrically different political preferences between the two groups. As insiders usually outnumber outsiders and are better organised and easier to mobilise, governments tend to side with insiders on issues where preferences differ (Saint-Paul 1996), thus cementing already existing disparities in labour market statuses.

In fact, as shown in Rueda's seminal work (Rueda 2005; 2006; 2007), it is particularly and somewhat counterintuitively Social Democratic parties and centre-left governments that cater mostly to labour market insiders, whom they perceive as their core constituents (Botero et al. 2004; Saint-Paul 2002; Siegel 2007). More recently, in contrast to this literature, Bürgisser and Kurer (2019) have argued that labour market policies enacted by left or Social Democratic party-led governments are decisively responsive to the interests of the specific composition of their voter base. Due to the recent increase in fragmentation of the voter base of Social Democratic parties in post-industrial societies, these interests have become less straightforward and more varied. They find that Social Democratic parties in government commanding more support from labour market outsiders will be likelier to champion policies benefitting outsiders and vice versa. This calls into question the aforementioned assertion that left parties are unidirectionally predisposed to catering to insider needs only, arguing instead that they are responsive to whoever they perceive as their most crucial voter base, which in turn depends on which group constitutes the greatest mass of voters and can reasonably be expected to participate in politics. They do agree, however, on the general premise that governments are responsive to particular voter groups, which can result in the further dualisation of labour markets if those groups are predominantly made up of labour market insiders.

Overall, we can maintain that, in the past, elected, i.e. office-seeking, governments contributed to a growing dualisation of the labour market through various pieces of legislation. By catering to the interests of labour market insiders, which traditionally wield greater influence over governments in power due to both sheer numbers and a higher degree of organisation, such legislation further protected their privileged status, thus fortifying and exacerbating labour market dualisation (Rueda 2007; Iversen and Soskice 2009; Häusermann and Schwander 2012; Emmenegger 2009; Ebbinghaus 2006).

The following section outlines a theoretical framework that serves to classify different forms of liberalising labour market reforms, accommodating both further dualisation and a recalibration of dualised labour markets.

3.2.2 Varieties of Liberalisation: A framework to understand different forms of labour market reforms

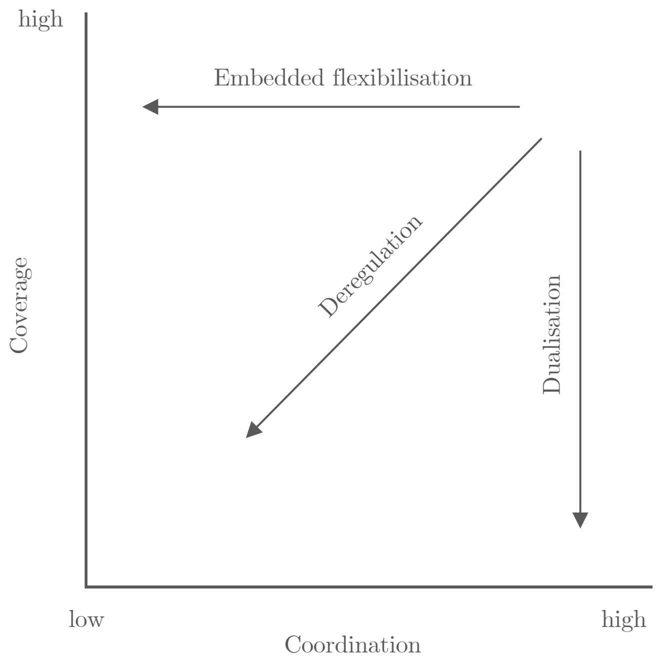
In order to conceptualise the different types of labour market reforms in the Eurozone crisis, this paper draws on the theoretical framework provided by Thelen (2014) dubbed *Varieties of Liberalisation* (see also Picot and Tassinari 2017). Building on earlier work (Hall and Thelen 2009, 22ff.), Thelen argues that, while labour market reforms since the 1980s generally followed the liberalisation principle as posited in the work of Streeck (2010; 2011), the term liberalisation itself is too encompassing to adequately explain the nuanced differences persisting in labour market reforms throughout the advanced capitalist democracies (Thelen 2014, 11).

Thelen devises a two-dimensional framework resting on the notions of 'coordination' and 'coverage' to accommodate these differences. Coordination refers to Hall and Soskice's interpretation of the term in the *Varieties of Capitalism* (VoC) literature (2001). Coordination is thus understood as the strategic interaction of economic actors through non-market institutions to facilitate economic activity. A high degree of coordination in the five spheres described in the VoC literature is typically characterised by strong and centralised wage bargaining institutions and long job tenure underpinned by strong employment protection legislation. This rests on firms' significant investments in employees developing industry-specific skills, which in turn necessitates the coordination between firms and the protection of such workers to secure a high return of such investments by retaining skilled workers in the company.

In an advancement of the VoC literature, Thelen raises the question of coverage in addition to coordination, arguing that a high degree of coordination in and of itself does not necessarily imply that the majority of firms participate in these coordinative processes and thus cover the majority of workers. Whether coordination covers only a small core portion of the workforce or indeed larger numbers typically depends on either the ability of coordinating institutions, such as trade unions, to force firms to adhere to such rules that would ordinarily not participate voluntarily, or the state – an actor purposely left out in the firm-centred VoC literature – imposing adequate legislation (Thelen 2014, 12).

In an age where liberalisation has been the chief principle for changes in the institutional setup of labour markets, this leaves three ideal-type reform trajectories: (1) embedded flexibilisation; (2) deregulation; and (3) dualisation (see Figure 21).

Figure 21: Varieties of Liberalisation



Adapted from (Thelen 2014, 13).

Embedded flexibilisation in this context refers to a reduction in coordination without restricting coverage. More generally, this involves policies aimed at making labour markets more flexible and workers mobile, thus increasing their exposure to market forces. However, this ideal-type reform process retains a certain degree of "supply side solidarity" (Baccaro and Locke 1998) aimed at reducing individual risks and protecting the most vulnerable. Typically, reform trajectories of this type follow the flexicurity principle of protecting individual workers but prying open labour markets to make them more flexible, and can be observed in the Scandinavian countries.

Deregulation denotes reforms that retrench both coordination and coverage. This type of reform typically involves policies that expressly dismantle labour market institutions such as collective bargaining arrangements, and often target labour unions as a vehicle of coordination. Not only do such informs increase the exposure of workers to market forces, they also entail a higher individualisation of risk (Hacker 2019). Such reforms constitute the most direct assault on all forms of worker protection and tend to be found more commonly in the Anglophone liberal market economies.

Lastly, dualisation refers to retrenching coverage but otherwise leaving coordination mechanisms among firms intact. Unlike embedded flexibilisation or outright deregulation such reforms thus do not constitute a direct impingement on labour market institutions. Instead, these reforms aim at narrowing the number of workers covered by the coordinating institutions. Effectively, this leads to a relatively stronger protection of those that are part of the core of protected workers in the face of a growing number of outsiders (Emmenegger et al. 2012). In fact, coordination between those firms left inside the core often intensifies, thus further exacerbating the divide between insiders and outsiders (Rueda 2007; Thelen and Van Wijnbergen 2003). Typically, dualising reforms do not touch for instance employment protection legislation per se, but constrict the number of jobs and workers that these types of legislation cover, for example by introducing different rules for new labour market entrants or by relaxing rules for temporary and forms of informal employment. Dualisation-focused reforms have been prevalent in especially Germany and France (Palier and Thelen 2010; Thelen and Kume 2006).

In the following section, the paper will unpack further the types of changes in labour market legislation to be expected in the context of the Eurozone crisis in Southern Europe in order to formulate testable hypotheses with regard to the design of the reform measures.

3.2.3 Labour market reforms in the Eurozone crisis

While the origins of dualised labour markets and the growing divide between labour market insiders and outsiders are well-documented, researchers have more recently turned to the issue of labour market dualisation in the face of economic crises and ensuing pressures to reform labour markets (Rueda 2014). In the particular context of the Eurozone crisis, countries in the currency union's periphery were faced with distinct challenges at the onset of the crisis which arose from the unique institutional structure of the EU, the incomplete architecture of the Economic and Monetary Union, and political dynamics between EMU member states revealing a dramatic misdiagnosis of the crisis: On the one hand, the rules of the Stability and Growth Pact substantially inhibited governments' room for fiscal manoeuvre and ruled out further financing of budget deficits to stimulate the economy. On the other hand, domestic governments' lack of control over the common currency foreclosed any possible ways of external devaluation to tackle the crisis. The ECB's inability to serve as a lender of last resort under the rules of the Maastricht Treaty further aggravated the situation (De Grauwe 2013; De Grauwe and Ji 2015; Iversen and Soskice 2018b).

Effectively, governments of the Eurozone periphery were left with internal adjustment measures as the only way of tackling the crisis, thus ushering in an 'age of austerity' (Armingeon and Baccaro 2012). Next to severe and immediate fiscal consolidation measures this entailed far-reaching structural reforms aimed at increasing economic competitiveness. This is entirely in line with the misdiagnosis of the crisis dominant among the political elites in the creditor countries as a crisis solely rooted in competitiveness problem. That means that, if a crisis is attributed to a lack of competitiveness of the domestic economic, regardless of whether this is an adequate view, deep structural reforms would be required to tackle the crisis. This argument is also closely connected with the pervasive view among the creditor countries, most notably Germany and the Netherlands, that current account deficits need to be addressed, while current account surpluses are perceived as signs of the competitiveness of their respective economies (Stockhammer 2011). The nature of such reforms over the past decades has conventionally taken the form of more or less unidirectional liberalisation (Streeck 2010; 2011), thereby gradually undermining the position of labour (Heyes, Lewis, and Clark 2012). Specifically, labour market reforms under the liberalisation paradigm typically entail deregulatory measures such as laxer employment protection legislation (EPL), as well as measures aimed at decentralising or reducing the scope of collective wage bargaining institutions.

Marrying the above-outlined insights on labour market dualisation and its origins, with the liberalisation paradigm observable in labour market reforms over the past decades, the particular case of Southern Europe warrants closer scrutiny. In many Southern European economies, labour market reforms prior to the crisis reflected the liberalisation paradigm only to some extent: While deregulatory measures affected large numbers of labour market outsiders in informal employment or temporary work, those in more protected forms of employment often remained shielded from such measures (Bentolila, Dolado, and Jimeno 2012; Dubin 2012).

Indeed, the Southern European countries have been characterised in the literature as displaying distinct features of dualised labour markets with a well-protected core workforce with access to generous benefits, and a large number of poorly protected workers employed in atypical work (Ferrera 2010). These accounts are clearly compatible with Thelen's theoretical framework, denoting predominantly dualising rather than wholly deregulating reforms in the Southern European context. In other words, labour market dualisation persisted throughout periods of liberalising reforms in Southern Europe.

The context of the crisis could in turn be interpreted as a window of opportunity to implement reforms with the aim of equalising long-standing and entrenched structural imbalances in Southern European labour markets and welfare states and break the trend of further dualisation (Hemerijck 2013; Petmesidou and Guillén 2014). The ensuing question is therefore whether the crisis constituted sufficient external pressure to force the Southern European governments' hands to lift some of the protective measures shielding the core workforce, or whether the crisis-induced reforms followed the familiar pre-crisis principle of dualising liberalisation, thus leading to a further deterioration of employment conditions for outsiders and leaving labour market insiders more or less untouched.

3.2.4 The involvement of the Troika and its impact on varieties of liberalisation in Southern Europe – the cases of Greece and Portugal

Virtually all of Southern Europe underwent more or less extreme phases of reorganising of labour market institutions from the beginning of the onset of the Eurozone crisis. Together with severe fiscal consolidation measures, labour market reforms accounted for a significant part of the structural reform side of the economic adjustment process in the Eurozone periphery (Armingeon and Baccaro 2012; Schmidt 2012). However, there is a considerable difference between those countries that enacted such reforms more or less on their own account and the countries placed under surveillance of the Troika of IMF, European Commission, and ECB. Certainly the former group of countries faced immense pressures to reform both from within, as well as externally through the bond markets, which led some commentators to speak of 'implicit conditionality' (Sacchi 2015). They are, nevertheless, distinct from the Troika programme recipient countries in that they retained a certain degree of independence with regard to choosing the exact reform design. As illustrated in the previous papers of this thesis in the context of fiscal reforms, the degree to which governments are independent from interference by supranational actors (even if that does provide significant limitations with regard to the larger reform strategy) has a substantial impact on how governments choose to distribute the adjustment burden of the reforms.

Labour market reforms with the aim of liberalisation and flexibilisation follow the same logic in that they invariably produce winners and losers: Regardless of any possible long-term improvements of growth prospects stemming from less rigid labour markets, those affected by liberalising reforms will at the very least in the short-run see their employment conditions worsen, while those that remain exempt from such measures will ultimately enjoy a higher degree of protection vis-à-vis those adversely impacted by the reforms. As illustrated in the dualisation literature, the design of labour market reforms and the choice between the different varieties of liberalisation posited by Thelen thus involve deeply political decisions by policy makers.

Given that the countries under Troika surveillance were markedly – although to differing degrees, as illustrated in Paper 2 of this thesis – constrained by the Troika conditionality in how they were able to design reform measures, the overall trajectory of labour market reforms may follow different logics. The Troika-controlled Southern European countries thus provide unique case studies that warrant closer scrutiny. In order to explain labour market reforms in these countries it is therefore necessary to go beyond the previously observed reform efforts in these countries and analyse specifically the likely impact of the Troika policy makers on the reform trajectories.

Firstly, the European integration process has been characterised as pushing for distinctly market liberal transformations (Scharpf 1999). On the one hand, this relates to structural factors in the architecture of the EU. In that sense, European integration has displayed a bias towards negative integration, i.e. deregulatory measures, with positive integration, i.e. re-regulatory measures at the European level, having proven to be difficult (Scharpf 2006). Furthermore, the European Court of Justice's "integration through law" (Scharpf 2010) has been identified as one key component in driving forward market liberal reforms (see also Beckfield 2019). Similarly, the European Commission, as guardian of the Treaties, has championed such market-liberal policies based on the ordoliberal model (Feld, Köhler, and Nientiedt 2015).

The Treaties ultimately reflected these principles and enshrined both strict rules under the Stability and Growth Pact as well as more recently the Fiscal Compact on the fiscal policy side (De Grauwe 2018; Fitoussi and Saraceno 2013) and a tremendous emphasis on price stability and political independence of the ECB (*Treaty on European Union* 1992, Art. 104(1), 105(1), 107), thus solidifying the market liberal direction of the European integration project (McNamara 1998). In the way that the EU economic policy consensus impacts the Troika's reform prescriptions through the roles of the European

Commission and the ECB as two of the three Troika institutions, it can be expected that the reforms reflect the same principles of fiscal prudence and market liberalism (Fitoussi and Saraceno 2004).

In the same vein, the IMF as the third Troika institution has in the past championed reforms that aimed to flexibilise markets and limit the role of the state more generally in countries under Fund surveillance. In devising the likely nature of the reforms advocated for by the Troika in the *Varieties of Liberalisation* framework, all three institutions are likely to push for deregulatory measures rather than reforms resulting in dualisation or embedded flexibilisation.

In fact, technocratic institutions such as the IMF understand dualised labour markets as an inefficiency and impediment to employment growth, and are therefore opposed to reforms that would further exacerbate the degree of segmentation in the labour market. In the past the Fund has on numerous occasions advocated to change or remove policies and regulations that contribute to the dualisation of labour markets, such as rigid employment protection legislation for workers on permanent contracts (Blanchard and Wolfers 1999; Di Tella and MacCulloch 2005; International Monetary Fund 2003; Lindert 2004; Nickell 1997; Siegel 2007). As to the dualisation framework, technocrats criticise such policies in particular when they create barriers to entry for the long-term unemployed or discriminate against certain labour market groups and thereby intensify market failures (Blanchard and Portugal 2001).

As a result, many IMF reform proposals in the past endorsed the 'flexicurity' model of highly flexible and deregulated labour markets on the one hand and the protection of the individual through the welfare state by expanding active labour market policies and the coverage of benefits on the other hand. However, as the countries under Troika surveillance simultaneously faced extreme pressures to rapidly consolidate public budgets, such reforms were likely to take the form of outright deregulation, a more far-reaching approach, rather than embedded flexibilisation.

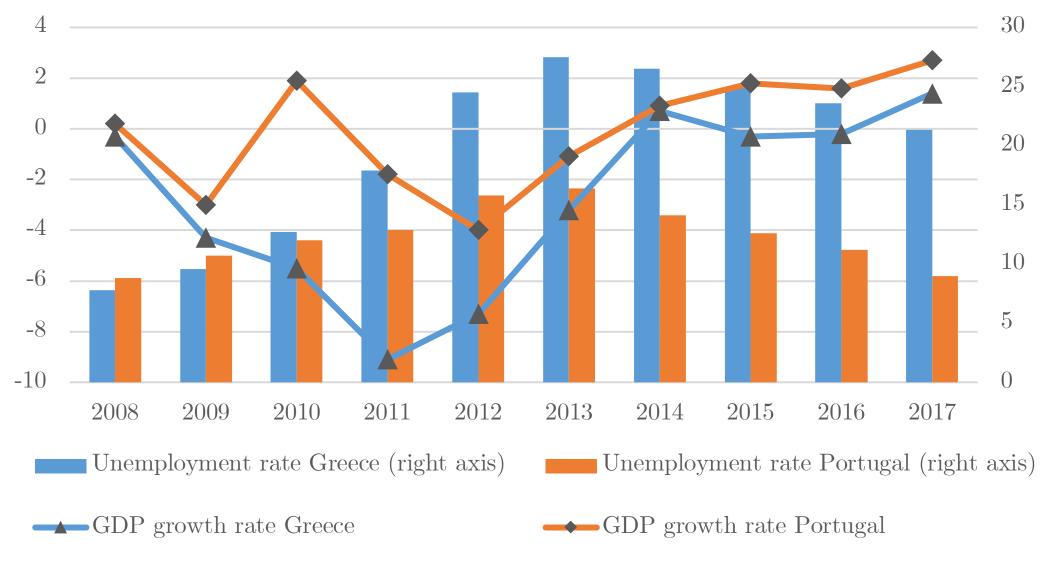
We can conclude from this that labour market reforms designed by technocratic policy-makers would not only be expected to be less responsive to the interests of labour market insiders than would be the case if such reforms were designed by democratically elected governments. They are, in fact, likelier to target the privileges of labour market insiders head-on in order to eradicate inefficiencies and impediments to employment growth. This dynamic can be expected to be particularly strong in cases where deep recessions necessitate comprehensive structural reforms.

3.2.5 Greece and Portugal as examples of highly dualised economies in deep recessions

In evaluating labour market reforms in the Eurozone crisis this paper homes in on the cases of Greece and Portugal. This is due to a number of reasons: Firstly, it allows for an ample comparison of the findings detailed in the previous papers on fiscal policy reforms and their effects on inequality with the issue of labour market inequality. Secondly, Greece and Portugal have already been identified as two most similar systems in a comparative case study design displaying a number of sufficient commonalities, most importantly in the setup of their welfare state regimes (Esping-Andersen 1990; Hemerijck 2013; Ferrera 1996; 2005; 2010; Rhodes 1996), which has a crucial bearing on their likely labour market reforms.

Third, Greece and Portugal both experienced severe economic crises with prolonged periods of negative economic growth as well as high unemployment in the aftermath of the 2008 global financial crisis and the ensuing sovereign debt crises in the Eurozone periphery (see Figure 22). Greece was profoundly hard-hit, with the economy contracting by 25% throughout the duration of the crisis and unemployment rates increasing beyond 20% of the active population since 2012. Portugal experienced negative growth rates between 2011 and 2013 and unemployment rates over 12% between 2010 and 2015. The deterioration of public finances ultimately led to both countries requesting financial assistance and became part of comprehensive Economic Adjustment Programmes (EAPs) outlining fiscal and structural reforms, the fulfilment of which were conditions for the financial assistance provided by their European partners and the International Monetary Fund.

Figure 22: Annual real GDP growth rate & unemployment rate Greece, Portugal



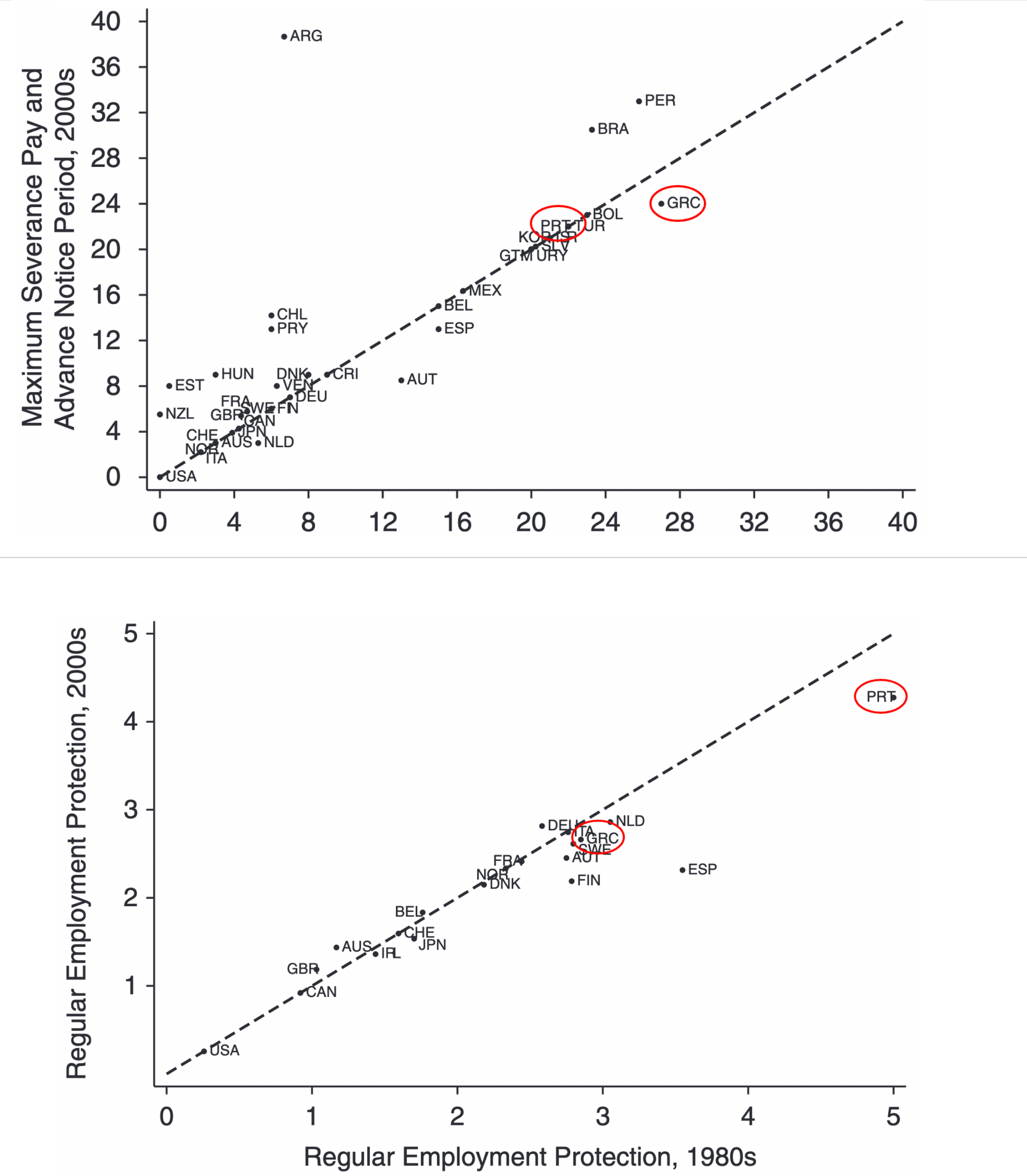
Source: Eurostat

It is also clear that the crisis hit Greece and Portugal in a similar fashion revealing deep structural weaknesses exacerbated by a steep fall in demand (as opposed to for instance Ireland where the crisis hit through the banking system; see Armingeon and Baccaro 2012, 175). Importantly, however, there was a difference in the magnitude of these structural weaknesses, which were much starker in the case of Greece and combined with years of unsustainable government spending held afloat only through fraudulent accounting (De Grauwe 2013; OECD 2010) leading to contagion effects that exacerbated the crisis in the rest of the Eurozone periphery including Portugal.

Fourth, both Greece and Portugal are examples of extremely dualised labour markets going into the adjustment process. Historically, the dualisation of labour markets began in earnest with increasing pressures stemming from employers demanding more flexibility in non-wage labour costs in an increasingly globalised world economy (Esping-Andersen 1985). In the Southern European countries in particular these pressures were combined with a predisposition for allowing capital and organised labour to share the exploits of protectionism in the formerly import substituting countries. For labour, this had meant high employment protection legislation as well as high wages in the protected (and uncompetitive) industries in exchange for labour peace which had set these countries on a path of labour market dualisation already by the 1960s and 1970s before opening up to world trade (Rueda, Wibbels, and Altamirano 2015, 94). Deindustrialisation gave these dynamics a further push as trade unions conceded to what was essentially the creation of a secondary labour market with cheap and more insecure employment in order to protect their constituents in the core of the industrial workforce (Palier and Thelen 2010). Again, this dynamic was more pronounced in the Southern European countries given that trade union density is significantly higher among labour market insiders compared to for instance the Continental welfare states (in which labour market dualisation is also a prevalent feature). The differential between insiders and outsiders grew further, illustrating that labour market dualisation in Southern "translates into a clear power resources dualism" (Häusermann and Schwander 2012).

There a number of ways to show these developments empirically. Rueda, Wibbels, and Altamirano (2015) in the work on the origins of dualism provide the following quantitative measures illustrating the high degree of labour market dualisation in Southern Europe and particularly Greece and Portugal. Figure 23 maps the patterns of employment protection for labour market insiders in a comparative fashion. The upper graph depicted in Figure 23 shows the costs for employers to initiate layoffs by combining severance pay, notice periods, and mandatory penalties enshrined in collective bargaining agreements or national legislation for workers with three years of job tenure in the respective firm. The data, based on Botero et al. (2004), provide two important insights: (1) costs for laying off labour market insiders are at a very high level in Greece and Portugal when compared to other countries in the sample in the 2000s. In fact, the only countries where labour markets were more protective of insiders when measured through this indicator were Bolivia, Brazil, Peru, and Argentina. The EAPs for Greece and Portugal would later mark this rather extreme protection of insiders as one of the key factors for the low levels of competitiveness going into the crisis (European Commission 2010a; 2011c); (2) There has been very little change in this regard between the 1980s and the 2000s. In fact, there was no change whatsoever observed for Portugal (indicated by the dotted line) and only some deregulation in Greece, where the costs for laying off labour market insiders were only slightly lower in the 2000s than in the 1980s. It should be noted that this appears to be a prevalent phenomenon across countries, although most other, especially European, countries register much lower overall values

Figure 23: Measures of employment protection for labour market insiders



<u>Notes:</u> The upper graph is based on data from Botero et al. (2004) that combines the costs of lay-offs for firms through the sum of the notice period, severance payments, and mandatory penalties stemming from e.g. collective bargaining agreements for workers with three years of job tenure. The lower graph is based on OECD data on procedural costs for employers intending to lay off workers (Venn 2009).

<u>Source:</u> taken from Rueda, Wibbels, and Altamirano 2015, 104

The lower graph in Figure 23 uses data from the OECD that go beyond the pure costs of layoffs in order to construct a measure protection for labour market insiders. Specifically, the measure includes: "(i) procedural inconveniences that employers face when starting the dismissal process, such as notification and consultation requirements; (ii) notice periods and severance pay, which typically vary by tenure of the employee; and (iii) difficulty of dismissal, as determined by the circumstances in which it is possible to dismiss workers, as well as the repercussions for the employer if a dismissal is found to be unfair (such as compensation and reinstatement)" (Venn 2009, 6). From this data we can conclude that (1) Portugal is the country with the highest degree of labour market insider protection in the sample, and in fact by a large margin (although there has been some trend for convergence towards the other European countries in the sample); (2) Greece, although slightly below Germany, Italy, and the Netherlands, also registers far up on the scale of insider protection going into the crisis (with a very minor decline between the 1980s and 2000s).

As EAP-recipient countries, both Greece and Portugal were forced to implement wide-scale reform programmes with extensive impacts on labour markets. Drawing on the dualisation literature, and the trends shown in Figure 23 with little to no change in the degree of protection of labour market insiders, we would ordinarily infer that such reforms in the two countries would work to further entrench the disadvantages of labour market outsiders while leaving the privileges of labour market insiders mostly in place, since the political processes from which dualisation originates do not change substantially in a recession. However, the EAP conditionality meant that policy-making competences had essentially been transferred in full or at least to a substantial degree to the technocratic policy-makers of the Troika. Therefore, as outlined in the previous section, the structural reforms of the EAPs can, in fact, be expected to have the opposite effect: The Troika is likely to identify policies and legislation that contribute to the high degrees of dualisation in the Greek and Portuguese labour markets as inefficiencies and impediments to sustainable employment growth. The reform prescriptions designed by the Troika are, therefore, likely to tackle these policies head-on and mainly target the privileges of labour market insiders in order to create more flexible and less dualised labour markets.

However, we also know from Paper 2 of this thesis that the reform process was not controlled to the same degree by the Troika in both countries. Due to stronger clientelistic linkages in Greece (Afonso, Zartaloudis, and Papadopoulos 2015; Hopkin 2015; Kitschelt and Wilkinson 2007; Lyrintzis 1984) and weaker state capacity to implement far-reaching reforms (Falkner et al. 2005; Featherstone 2011; Hartlapp 2005; Mitsopoulos and Pelagidis 2011; Sotiropoulos 1993), the Troika took stronger ownership of the reform process and all but micromanaged the Greek reforms while issuing more general reform targets for Portugal, the exact design of which was left more to the discretion of the domestic government. This greater room for autonomy was facilitated by stronger veto points in Portugal, such as the Constitutional Court, which was instrumentalised repeatedly by both the President and different opposition parties to halt a number of Troika reforms (Cisotta and Gallo 2014; Moury and Standring 2017).

For these reasons, stronger deviations from the thrust of the assumed deregulatory reforms induced by the Troika are possible in the case of Portugal, while in Greece this line of labour market reform prescriptions is likely to be followed more closely. In other words, labour market insiders in Portugal are likely to be affected less detrimentally by the labour market reforms under the EAPs and retain more of their privileges than those in Greece.

3.2.6 Research question and hypotheses

This paper's aim is to extend the analysis of the previous two papers to the realm of labour market reforms. It therefore sets out to show firstly which trajectories in the sense of *Varieties of Liberalisation* (Thelen 2014) the labour market reforms in Greece and Portugal follow. From the dualisation literature we know that, if a recession is deep enough to trigger large scale structural reforms, governments are likely to respond to such pressures by further flexibilising employment conditions of outsiders rather than retrenching the privileges of labour market insiders. However, in cases where technocrats determine policy prescriptions, their distributive effects can be radically different as technocrats are not subject to the same political processes as elected governments and can afford to upset groups that are considered key to a government's re-election. It is expected that in the case of Greece and Portugal, the Troika pushed for deregulatory reforms, specifically to retrench the privileges of labour market insiders in order to do away with the high degree of labour market dualisation in the two countries. This is because segmented labour markets are seen as an impediment to economic growth in the economic orthodoxy dominant in the Troika institutions. The different degrees of control over the reform process can, however, impact the reform trajectories substantially. On this basis, the paper formulates the first set of competing hypotheses:

$\underline{H_1}$: Given the Troika's predisposition to champion market liberal reforms and the absence of electoral pressures for the unelected technocrats of the Troika that would otherwise result in the protection of important groups of labour market insiders, the labour market reforms in Greece and Portugal are expected to follow deregulatory principles, and specifically retrench the privileges of labour market insiders.

$\underline{H_2}$: Given the higher degree of control exercised by the Troika in Greece, the Greek reforms are expected to be deregulatory. Conversely, labour market reforms in Portugal are expected to contribute to further dualisation due to the lower degree of control exercised by the Troika, which leaves in place the political dynamics that engendered labour market dualisation in the first place, such as office-seeking governments shielding electorally important groups of insiders.

However, aside from the reform prescriptions negotiated between the Troika institutions and the respective domestic governments on the one hand and the reforms ultimately implemented in practice on the other, it is also necessary to consider concrete labour market outcomes for both labour market insiders and outsiders throughout the crisis and the reform process. As labour market insiders enjoy a higher degree of job protection and thus lower risk of becoming unemployed than labour market outsiders, it is reasonable to assume that during times of economic recession, outsiders will be hit first by ensuing increases in unemployment. In fact, we know from the dualisation literature that labour market outsiders function as a form of buffer, protecting insiders from unemployment (Rueda 2007; 2014). This is due to firms reacting to economic downturns primarily by either terminating those workers that are on more flexible contracts first, i.e. workers that can be labelled as labour market outsiders, or slashing their work hours (Eichhorst, Feil, and Marx 2010).

Therefore, the severe recessions and high levels of unemployment that both countries experienced can be expected to have led to labour market outsiders being displaced in larger numbers. However, as a result of the reform measures, insiders should become increasingly less secure and thus approach similar levels of unemployment risks as labour market outsiders as the EAPs progress. On this basis, the following competing hypotheses building on the previously outlined ones are formulated:

$\underline{H_3}$: As a result of uniformly deregulatory labour market reforms, both labour market insiders and outsiders experience a higher risk of unemployment in Greece and Portugal. In relative terms, the differences between the two groups are expected to shrink as predominantly labour market insiders' privileges are retrenched.

$\underline{H_4}$: As a result of deregulatory labour market reforms in Greece and dualising ones in Portugal, labour market insiders in Greece are expected to experience an increased risk of becoming unemployed, while remaining relatively more shielded from the recession in Portugal. Labour market outsiders in Portugal retain their buffer function shielding labour market insiders from exposure to unemployment.

3.3 Research design

3.3.1 Analysing labour market reforms through the Varieties of Liberalisation lens

The analysis of labour market reforms in Greece and Portugal and classification as either deregulatory or dualising involves three steps. Firstly, the documents of the Economic Adjustment Programmes for both Greece and Portugal are dissected according to the outlined reform measures. Specifically, the documents will be scanned for passages that reveal the Troika's aims with regard to tackling the dualisation of labour markets. Secondly, the ex-post evaluations of the EAPs for Greece and Portugal conducted individually by both the IMF and the Commission are analysed in order to gauge whether the reforms have been implemented according to the prescriptions of the Troika.

Thirdly, the Troika's views of the reform success in the two countries are juxtaposed with the implemented reform measures throughout the years of the EAPs. For this purpose, the paper makes use of the European Commission's LABREF database, which maps all labour market reforms in EU member states until 2016 (Turrini et al. 2015). In order to test the paper's hypotheses and classify the reforms according to Thelen's framework as either deregulatory or dualising, it is necessary to explain the operationalisation of the two dimensions 'coordination' and 'coverage'. Utilising the LABREF database the analysis focuses on the following policy areas of labour market reforms: employment protection legislation (especially pertaining to dismissal rules), wage setting, and working time. All reforms in these areas implemented throughout the duration of the EAPs are then categorised according to whether they serve to deregulate or dualise[26].

3.3.2 Measuring labour market dualisation

In addition to the analysis of the reforms by content, the paper takes two distinct steps in measuring labour market dualisation: First, it uses a quantitative measure of labour market outcomes for different groups, which offers significant insights as to how the degree of dualisation has developed throughout the crises in Greece and Portugal and the ensuing adjustment processes. In the second step, the paper captures transitions of individuals between different labour market groups, such as from insider to outsider, or from insider/outsider to unemployed, which in turn allows us to assess the

[26] For the sake of completeness, the reforms will also be analysed according to whether they represent Thelen's third category of labour market liberalisation, i.e. 'embedded flexibilisation'.

unemployment risks associated with belonging to a specific labour market group.

For the purpose of the analysis in this paper, we are specifically interested in (1) quantifying different labour market groups, and (2) transitions between those labour market groups. Researchers have developed a number of different measures to determine an individual's affiliation with a labour market group at a particular point in time. [27] This analysis uses a status-based operationalisation of insiderness based on Rueda (2007), which understands labour market insiders as those in secure forms of employment and outsiders as those in atypical forms of employment. This operationalisation is one of the most widely used in the literature and adopted here because it is best-suited to meet its analytical purpose of mapping labour market processes as well as picking up the effects of structural reforms (Schwander and Häusermann 2013; see also Marx and Picot 2020 for an in-depth discussion of the operationalisation).

Using the cross-sectional panel of EU-SILC data, the paper follows academic convention as laid out in Rueda (2007) and restricts the sample to individuals of working age (i.e. between 15–64 years old). Following convention, the following individuals are coded as insiders:

(1) Individuals with long-term employment contracts;
(2) Voluntary part-time workers, if they work at least 20 hours per week;
(3) The self-employed, if they have employees working for them. This is a particularly noteworthy qualification as the share of the self-employed is high in Southern Europe but differences in labour

[27] For a detailed account of different operationalisations of labour market insiders and outsiders see Rovny and Rovny (2017).

market vulnerabilities among the group is large (e.g. self-employed lawyers and pharmacists, vs. shopkeepers).

Conversely, the following individuals in the sample are coded as outsiders:

(1) Individuals with temporary or fixed-term employment contracts;

(2) Involuntary part-time workers;

(3) Part-time workers working less than 20h per week;

(4) Self-employed individuals if they do not have employees working for them;

(5) Family workers.

Additionally, individuals are coded as unemployed in a separate group from labour market outsiders if their self-reported economic status labels them as such, and inactive if they are in training or unpaid work, military or community service, retirement, if they are permanently disabled, fulfilling domestic tasks, or if they are otherwise inactive. The empirical analysis thus allows us to aggregate individuals who are either insiders, outsiders, unemployed or inactive and trace changes in the total number of individuals of each status over time and, in particular, through the crisis and the structural reform process.

In addition to this first status-based operationalisation, the paper traces individuals throughout different years, detecting labour market transitions, following the approach utilised in Ray and Schwander (2018). In particular, the status-based operationalisation founded on cross-sectional EU-SILC data in each year is unable to show whether the group of newly unemployed individuals is comprised of formerly atypically employed individuals i.e. labour market outsiders, or insiders. This gap is bridged by employing the longitudinal panel of EU-SILC data, which traces individuals through four years, thus picking up three possible transitions of individuals between labour market groups. For the purposes of this second part of the analysis, inactive individuals are excluded, and insiders, outsiders and unemployed coded as above, i.e. using, again, the status-based operationalisation to determine which labour market group each individual is classified to be part of. Based on the availability of data, this step in the analysis makes one deviation from the approach outlined above: Since the longitudinal panel does not contain information on the reasons for being in part-time work, individuals in part-time employment are all labelled as outsiders. In the original contribution by Rueda (2007), who uses cross-sectional data, the distinction between voluntary and involuntary part-time workers is sensible. However, a large number of other studies, even when using cross-sectional data which allow for this distinction, has omitted this variable and categorised part-time workers generally as labour market outsiders (Marx and Picot 2020).

This analysis sheds light on whether the expectations based on the dualisation literature can be confirmed, i.e. whether the group of labour market outsiders has in fact served as a buffer during the recessions in Greece and Portugal, and secondly, whether this buffer function has remained unchanged throughout the structural reform process. A negative answer to this question would imply that labour market insiders were in fact not shielded by the buffer of labour market outsiders, and suggest that the structural reforms of the Economic Adjustment Programmes targeted insiders and their labour market privileges, as well.

3.4 Empirical Analysis and Findings

3.4.1 The Troika prescriptions: Uniform blueprint or country-specific reforms?

The EAP-related documents reveal the following priorities governing the Troika's reform prescriptions. The first EAP for Greece emphasises specifically that (1) the Greek labour market is deemed to be too rigid, pointing to high levels of employment protection, stating that "reforms are, in particular, needed to [...] render product and labour markets more efficient and flexible" (European Commission 2010, 15). Furthermore, the EAP shows that (2) this constitutes an impediment to a return to economic growth: "Unless tackled in earnest, structural rigidities may undermine the Greek economy's capacity to adjust to the current situation" (ibid., 10), making the flexibilisation of the Greek labour market a key priority of the reform programme.

Tackling labour market dualisation specifically is not mentioned by name in the first EAP for Greece, although the problematisation of the very high degree of job protection for key groups in the labour market in the EAP suggests that the Troika was aware of this issue and sought to address it. The overall trajectory of the planned reforms, however, seem to follow a generally more unconstrained deregulatory thrust rather than targeting labour market insiders exclusively.

In its more specific diagnosis of the features of the Greek labour market that are deemed problematic by the Troika, the first EAP identifies three core issues, all of which point to a high degree of coordination for (at least) a core workforce, thus leaving others at the margins:

> "Firstly, Greece's **high employment protection legislation** for temporary workers combined with higher levels of protection for

> permanent white-collar workers hinders young workers', women and long term unemployed entry and re-entry into the labour market as well as their transition into permanent contracts. Secondly, specific characteristics of the wage bargaining system (such as the **extension of collective agreements to all enterprises**, including those not involved in the negotiations) prevent wage moderation and put pressure on inflation. Moreover, wage bargaining processes have also resulted in setting relatively **high minimum wage levels, thereby hindering labour demand of young workers**, who are also affected by the lack of proper links between formal education and training and the needs of the labour market. Thirdly, Greece has a substantially higher rate of in-work poverty risk compared to the EU, though, given the high share of undeclared work, this figure needs to be treated with caution." (ibid., 28)

It is clear from this passage that the Troika reform prescription would constitute nothing less than a direct attack on coordinating institutions with the aim of flexibilising the labour market. It also evident from the mention of in-work poverty that the Troika deems such reforms as necessary preconditions for a more efficient labour market, subscribing to the neoliberal view that ultimately all workers would benefit from such deregulatory reforms. Troika policy makers also and somewhat uncritically accept the view that such reforms would ultimately result in higher equity by reducing inefficiencies:

> "Labour market reforms will spur job creation and increase wage flexibility. Other than efficiency aspects, reforms are also needed to improve equity, therefore increasing job opportunities for the young and long term unemployed and improving access to services." (ibid., 25)

The Troika issued concrete reform prescriptions to address the rigidity of the labour market, all of which are aimed at across the board flexibilisation, outlining that:

> "Government amends employment protection legislation to extend the probationary period for new jobs to one year, to reduce the overall level of severance payments and ensure that the same

> severance payment conditions apply to blue- and white-collar workers, to raise the minimum threshold for activation of rules on collective dismissals especially for larger companies, and to facilitate greater use of temporary contracts and part-time work." (ibid., 73)

The reform prescriptions also contained more direct attacks on wage coordination institutions, requiring the government to:

> "adopt legislation to reform the wage bargaining system in the private sector, including local territorial pacts to set wage growth below sectoral agreements; introduce variable pay to link wages to productivity performance at the firm level; [...] adjust legislation to introduce annual time accounts and reduce overtime pay." (ibid., 85)

In the second EAP, signed after two years of deep economic recession and painful fiscal and structural reforms in 2012, the Troika reaffirmed its position with regard to the prescribed flexibilisation of the Greek labour market. In fact, despite the reform efforts, the Troika seemed to depict the prevailing rigidity of the labour market as one contributing factor to the depth of the crisis. At the same time it acknowledged the distributive conflicts induced by the reforms, although the Troika reasserted its view that reforms that are painful for some are necessary to achieve higher overall equality (in other words, the Troika subscribed to the view that higher equality cannot only be achieved by improving the situation for the more vulnerable but also simply by making those at the top worse off):

> "Despite a considerable reduction in per capita income, downward rigidities in wage-setting systems have prevented the necessary adjustment of private sector wages; this has contributed to a sharp increase in unemployment. The government has adopted several measures in relation to collective bargaining, so as to reduce the downward rigidity on wages and facilitate recruitments." (European Commission 2012a, 9)

Unsurprisingly, given this diagnosis, the prescribed reforms in the second EAP can be clearly labelled as ‘more of the same’, although the reform progress was increasingly pressing in the face of the crumbling Greek economy. Specifically, the Troika stated in the second EAP:

> “In a context of a sharp decline in employment, emergency action was needed to ensure the quick responsiveness of wages to the fall in economic activity. The authorities and the mission staff discussed and agreed on a package of actions to be taken by the Government in the short term, which should contribute to reduce labour costs in the business sector by 15 percent over the programme horizon.” (ibid., 38)

Further reform prescriptions reaffirming the flexibilisation paradigm in the second EAP were:

> “The measures decided by the government build on two pillars: an adjustment of wage floors and a revision of the collective bargaining system, with a view to spurring and easing contract renegotiation and promoting wage flexibility [...] The downward wage flexibility helps viable companies to reduce their production costs, thus creating potential gains in external market shares, promote investment and thus, to accelerate the much needed change in the structure of the economy.” (ibid., 38)

One specific area in which the Troika identified need for action concerned the newly privatised former state-owned enterprises, again with a distinctly deregulatory tone:

> “Privileged labour conditions in former state-owned firms will be better aligned with those in the rest of the private sector. Privatised former SOEs are not competitive if they are forced to inherit labour conditions from the public sector, which notably have included public-sector-like tenure and very generous automatic wage increases.” (ibid., 40)

Based on both the Troika’s diagnosis of the ailments of the Greek labour market as being too rigid and protective of its workers – particularly, though not exclusively, for a core group of insiders – and the prescribed cures as laid out in the first and second EAPs for Greece, it is clear that the reform measures were aimed at reducing both coordination, and coverage, thus falling into the category of deregulation in the *Varieties of Liberalisation* framework. This is in line with both H_1 and H_2, since, firstly, it was expected that the Troika would (1) identify a need for action with regard to rigid and dualised labour markets, and (2) favour outright deregulatory reform measures over other types of reforms that would aim at either lowering coordination or coverage but not both. Secondly, the higher degree of control exercised by the Troika over the Greek reform process was expected to result in the Greek reforms reflecting this deregulation paradigm more closely. In order to test for the validity of the competing H_1 and H_2, the reform measures laid out in the Portuguese EAP need to be analysed according to the particular reform trajectory, and specifically, whether the reforms in Portugal mirrored those in Greece or were of a more dualising nature as a result of the higher degree of discretion retained by the Portuguese authorities.

From the outset, the Portuguese EAP displayed remarkable similarities with the two Greek programmes analysed here in that rigid labour markets, and the policies pertaining to it such as strict employment protection legislation, were identified as a key problem for economic growth. More specifically, the Portuguese EAP reads:

> "Labour market reforms are key to improve growth prospects and recover competitiveness. The most critical are excessive employment protection of permanent contracts, generous unemployment benefits, rigid working-time arrangements and a wage bargaining system that has not been capable to keep wage growth aligned to developments in productivity and external competitiveness. The rules for individual dismissal of permanent workers are strict and the compensation upon dismissal high by international standards. The strong protection of workers on permanent contracts has led to a two-tier labour market. The strict employment protection legislation (EPL) is also responsible

> for the very low labour turnover and very long duration of unemployment. Restrictive dismissal rules combined with generous severance payments may also have contributed to higher wage outcomes. Furthermore, the rigid working time regulations represent a burden on firms and hamper labour mobility and job creation.“ (European Commission 2011c, 12)

In a departure from the diagnosis of the Greek labour market inefficiencies, the Troika addressed the issue of labour market dualisation more specifically. In that sense, the high degree of employment protection for some workers is specifically singled out as coming at the cost of other workers in atypical forms of employment, thus rendering the labour market overall less efficient and impeding growth prospects: “Employment protection legislation (EPL) will be revised to reduce labour market segmentation” (ibid., 25). For instance, while in the Greek programmes, the stronger use of temporary work was given out as a possible policy area to improve labour market efficiency, the opposite is the case in Portugal where the use of temporary work was deemed already excessive and thus creating inefficiencies in its own right:

> “The Programme foresees comprehensive labour market reforms to reduce duality, enhance incentives to work, and promote a better alignment of working arrangements and wages to specific firm conditions. Excessively strict employment protection reduces job creation, hinders mobility to dynamic sectors, and favours a disproportionate use of temporary contracts. The precarious and uncertain labour market status of most young workers dents their human capital potential and productivity prospects.” (ibid., 24)

More specifically, the Troika regarded the asymmetry between open-ended and fixed-term contracts as one of the core issues pertaining to the dualisation of the labour market and therefore prescribed concrete reforms to balance the two:

> “In the current legal framework, two main elements make temporary contracts more attractive to the employer: The first is the level of severance pay that is higher for workers on open-

> ended contracts. The second is the narrow definition of fair dismissals that increases the risk for employers to enter into open-ended contracts." (ibid., 26)

The reforms envisioned by the Troika to address this were largely aimed at breaking the privileges of protected labour market insiders with open-ended work contracts by:

> "(i) aligning the severance payment regime of open-ended contracts to that of fixed-term contracts; (ii) bringing the level of severance payments closer to that of other EU countries; (iii) making the definition of fair dismissal for open-ended contracts less restrictive; (iv) easing job-to-job mobility by making part of the severance payments portable via the creation of a fund financing notional individual accounts (in analogy with the Austrian system)." (ibid., 25)

Based on the reforms outlined in both the Greek and Portuguese EAPs, two findings stand out: (1) In both countries, the Troika aimed at implementing reforms following flexibilisation across the board in order to lower the rigidity of the Greek and Portuguese labour markets. Given that all workers, though to different degrees, were to be affected by these reforms, in other words they were aimed at lowering both coordination and coverage, the reform trajectory can be labelled as deregulatory in the *Varieties of Liberalisation* framework. To a certain degree, the Troika seemed to have used one blueprint of ideal labour market reforms for both countries. This is particularly obvious in the Greek case where the deeper-than-anticipated recession was met with a more-of-the-same type of approach the reform effort.

However, (2) while the issue of labour market dualisation is implicitly addressed in the Greek case, the Troika is more explicit about aiming to break insider privileged in order to bring about lower labour market segmentation in the Portuguese case. This is because dualised labour markets are deemed inefficient and therefore hindering economic recovery, the achievement of which remained the key goal of the Troika.

These findings lend credence to H_1 in that there seems to be a uniformly deregulatory reform trajectory outlined in the reform prescriptions of the Troika. This is, firstly, based on the Troika identifying rigid and dualised labour markets as having a negative impact on economic growth by creating inefficiencies. Secondly, this is facilitated by the Troika's liberty to target labour market insider privileges, which is typically more difficult for office-seeking governments as labour market insiders tend to represent a large and well-organised voter group whose support is often perceived as essential for a government's re-election.

However, as we know from Paper 2 of this thesis, there was substantial conflict between the Troika on the one hand and the domestic governments and institutions and the other hand, fuelled by large-scale protests against the reforms in both Greece and Portugal. These conflicts played out differently in the two countries, however, and pushback in the case of Greece was, firstly, less effective from the outset and, secondly, met with zero tolerance on the part of the Troika, while in the case of Portugal there were substantial revisions of the reform prescriptions in the implementation stage in the realm of fiscal policies. In order to assess the validity of H_2 in particular, which assumed different reform trajectories in both countries (Troika-style deregulation in Greece, dualisation in Portugal) it is therefore necessary to evaluate not just the reform prescriptions but also the implemented reforms.

For that purpose the remainder of this section presents evidence from the European Commission's LABREF database which captures all labour market reforms implemented until 2016, thus covering the duration of the Portuguese

EAP and the first two Greek EAPs. Following Picot and Tassinari (2017) the most significant reforms in the realms of EPL, wage setting and working time are assessed according to whether they can be classified as lowering the degree of coordination but leaving the level of coverage intact (embedded flexibilisation), lowering both coordination and coverage (deregulation) or whether they leave coordination intact but limit the number of workers covered by the coordination mechanisms (dualisation). The three categories represented the three varieties of liberalisation presented by Thelen (2014).

This analysis yields two interesting results that allow for a further evaluation of the two competing hypotheses H_1 and H_2. Firstly, the overall reform trajectory prominently features 'embedded flexibilisation' measures, which calls the specification formulated in H_1 that the Troika reforms would follow deregulatory principles into question (see Table 6 and Table 7). It should be noted, however, that the general validity with regard to the second specification, i.e. the retrenchment of insider privileges is not infringed upon: Labour market reforms following the principle of embedded flexibilisation do, in fact, retrench insider privileges by lowering the degree of coordination that resulted in the establishment of these principles in the first place.

Secondly, there are marked differences between the Greek and Portuguese reform trajectories: While in Greece, only one in five out of the 20 major labour market reforms assessed for the scope of this analyses can be labelled as dualising, in Portugal almost half of the 15 major labour market reforms had a dualising effect. These reforms are likely to further deteriorate the employment conditions of labour market outsiders such as young or temporary workers or newly hired workers. In light of this difference, the evidence lends credence to H_2 rather H_1. Again, it needs to be noted that the reform path in Greece, which was more strongly controlled by the Troika, resembled embedded flexibilisation more than wholesale deregulation, both of which, however, lower the degree of dualisation in the labour market as they retrench the privileges of insiders.

To recapitulate, H_2 stipulated that the reforms in Portugal are likely to have a more dualising effect than those in Greece, due to higher degree of discretion vis-à-vis the Troika retained by the Portuguese government. In order to conclusively validate H_2, there would, therefore, have to be evidence of conflicts between the Troika and the Portuguese authorities, and of a lack of implementation of some of the reform measures outlined by the Troika, particularly with regard to those that were aimed at lowering the degree of dualisation of the Portuguese labour market. For that purpose, the following section provides an analysis of the ex-post evaluations of the first and second EAPs for Greece, whose duration corresponds with the data available from the LABREF database, and the EAP for Portugal, conducted individually by the IMF and the European Commission.

Table 6: Implemented labour market reforms and reform trajectories in Greece			
Policy Area/ Year	Policy Change	Reform Trajectory	Source
Employment Protection Legislation			
2011			
	Extension of maximum duration of fixed-term contracts	Dualisation	Law 3986/2011
2012			
	Reduction of notice periods by 1 month for tenures of 15-19 years (2 months for tenures of > 19 years)	Deregulation	Law 4093/2012
	Introduction of caps for severance payments	Embedded Flexibilisation	Law 4093/2012
	Abolishment of all rules providing special protection against dismissal beyond the common regulations of dismissals	Deregulation	Law 4046/2012
Wage Setting			
2011			
	Cut in productivity allowance in government sector	Embedded Flexibilisation	Law 4002/2011
	Freeze of government wage drift	Embedded Flexibilisation	Law 3986/2011
	Reduction in maximum hours of overtime in government sector from 40 to 20 hours	Embedded Flexibilisation	Law 3986/2011
	Increase in weekly working hours in government sector to 40 h/week for some personnel	Embedded Flexibilisation	Ministerial Decision Nr 14757/27-5-2001

	Possibility of undercutting wages set in collective agreements by up to 20% for new hires	Dualisation	Law 3986/2011
2012			
	Reduction in salaries of special wage regimes (judges, army, universities, doctors and the like) of general government	Embedded Flexibilisation	Law 4093/2012
	Freeze of rank promotions for ordinary civil servants	Embedded Flexibilisation	Law 4046/2012
	Implementation of single public sector wage grid to personnel of Legal entities of private law + SOE's and abolition of additional allowances	Embedded Flexibilisation	Law 4093/2012
	Reduction of survival period of expired collective bargaining agreements to 3 months	Embedded Flexibilisation	Law 4046/2012
	Introduction of caps for duration of collective agreements (3 years)	Embedded Flexibilisation	Law 4046/2012
	Reduction of legally-binding wage floors by 32% for workers under 25	Dualisation	Law 4046/2012
	Reduction of legally-binding wage floors by 22%	Embedded Flexibilisation	Law 4046/2012
	Suspension of automatic wage increases	Embedded Flexibilisation	Law 4046/2012
2014			
	Reduction of maturity allowances for workers under 25	Dualisation	Law 4254/2014
2015			
	Introduction of link between wages and performance for public sector employees	Deregulation	Law 4354/2015
Working Time			
2011			

	- Increase of maximum duration of periods of increased and reduced work from 4 to 6 months during the reference period. - Elimination of wage top-up (of 30% and 75%) for work in excess of the reduced hours - Implementation possible without agreement by unions	Deregulation	Law 3986/2011

Sources: Based on LABREF database (European Commission 2019)

Table 7: Implemented labour market reforms and reform trajectories in Portugal

Policy Area/ Year	Policy Change	Reform Trajectory	Source
Employment Protection Legislation			
2011			
	Reduction in severance payments - for new hires from 30 to 20 days - abolishment of 3 month minimum severance payment - Introduction of maximum severance payment limited to 12 months or 240 times the minimum wage	Dualisation	Law 53/2011
	Reduction in severance payments for temporary workers	Dualisation	Law 53/2011
2012			
	Changes in the definition of fair dismissals - For redundancies - elimination of the need to follow a specific order of dismissal - For unsuitability - possibility of a fair dismissal based on unsuitability without previous changes to the job post being introduced - For both types of dismissals - end of the obligation for the employer to show that no other compatible post exists in the firm	Deregulation	Law 23/2012
	Extension of the duration of fixed-term employment contracts otherwise terminated by 30 June 2013	Dualisation	Law 3/2012
	Reduction in severance payments for old and new hires (both permanent and temporary workers)	Embedded Flexibilisation	Law 23/2012
2013			

	Further reduction in severance payments for new hires from 20 to 12 days of base salary per year of service (permanent contract) or 18 days (temporary contract)	Dualisation	Law 69/2013
	Increase in maximum number of renewals of fixed-term contracts by 12 months	Dualisation	Law 76/2013
Wage Setting			
2011			
	3.5-5% public sector pay cut for salaries higher than 1500 euros per month	Deregulation	/
	Suspension of close-to-automatic extensions of wage agreements	Embedded Flexibilisation	/
	Freezing of minimum wage for duration of EAPs	Dualisation	MoU
2012			
	2-year suspension of collective agreements and employment contracts'	Deregulation	Law 23/2012
	Reduction of firm threshold from 500 to 150 workers for works councils be entitled to delegation from union to conclude collective agreements.	Deregulation	Law 23/2012
2014			
	Flexibilisation of collective bargaining agreements by: - Reducing survival period expired collective bargaining agreements - Reducing expiration period for collective bargaining agreements	Embedded Flexibilisation	Law 55/2014
Working Time			
2012			
	Reduction of overtime compensation for workers not covered by collective bargaining agreements: - Limitation of additional pay for overtime up to 50% - Elimination of compensatory time-off	Dualisation	Law 23/2012

2013			
	Increase of working time from 35 to 40 h/week for civil servants	Embedded Flexibilisation	Law 68/2013
Sources: Based on LABREF database (European Commission 2019)			

3.4.2 Evidence of reform compliance from the Troika's ex-post evaluations of the EAPs

A review of the ex-post evaluations yields the following. In their evaluation of the first EAP for Greece, the IMF states that the reform was initially satisfactory as well as targeting the right issues in terms of flexibilising the labour market:

> "The program initiated a comprehensive agenda of structural reforms that included reducing public sector wages; liberalizing wage-setting and loosening employment restrictions in the private sector; improving the business environment by cutting red tape; and reducing barriers to entry and market distortions in protected industries. The program began with some deregulation (fast-track investment and one-stop shop legislation), but labor market reforms were not initially deep enough to tackle entrenched labor market inflexibility." (International Monetary Fund 2013, 36)

By the time of the conclusion of the second EAP, however, reform progress had slowed down markedly. Specifically, the IMF attests:

> "Even though labor market reforms bore fruit early on—with a noticeable decline in unit labor costs—significant restrictions regarding collective dismissals, industrial actions, and the setting of minimum wages remained in place." (International Monetary Fund 2017, 24)
>
> "A measure of progress toward the EFF objectives was achieved, but the program ultimately foundered in the face of adverse political developments." (ibid., 37)

However, while the general reform progress slowed down as the recession deepened and political turmoil increased due to mounting opposition towards the reform prescriptions, which is in line with other accounts of the Greek reform efforts (see e.g. Matsaganis 2018), there is no evidence that the reform trajectory itself changed. Moreover, the IMF's ex-post evaluations do not mention increases in labour market dualisation or even the persistence of dualisation due to the slowing reform progress. The main criticism of the IMF instead seems to have been that deregulation, despite some progress, did not go far enough.

With regard to the labour market reforms in Portugal, the European Commission reiterates in its ex-post evaluation of the EAP the high degree of labour market dualisation in Portugal going into the crisis:

> "The biggest issues that Portugal faced prior to the programme were: excessive employment protection of permanent contracts, leading to dualism" (European Commission 2016, 72).
>
> "Strict rules for individual dismissal of permanent workers were both a chronic and an acute problem for the Portuguese economy. They hindered the creation of permanent jobs and had helped to create a dual labour market" (ibid., 75).

In this regard, the Commission reports some progress in implementing reforms aimed at reducing the dualisation in the labour market. However, similar to the case of Greece, reform progress stalled after the initial stage due to the interference by the Constitutional Court, in addition to direct pushback from the government itself:

> "Important labour market reforms were adopted during the programme, and firms consider them to have had a significant impact, but the momentum of reform dropped over time. This has helped to make the labour market more flexible, and to an extent to reduce undue protection of insiders at the cost of outsiders. Labour market reforms were relatively front-loaded compared to other structural reforms. In part this was due to

> good progress at the start of the programme. However both legal rulings and government policy decisions set back the process of labour market reform towards the end of the programme and in its aftermath." (ibid., 79f.)

The Commission is specific in its assertion that, unlike in Greece, where the reforms went in the right direction but not far enough, the reform progress in Portugal is more disappointing with regard to the issue of labour market dualisation:

> "Unemployment in Portugal is high and the labour market is still segmented" (ibid., 132). [The reform] measures did not bring about the expected improvements in terms of employment and reduced segmentation" (ibid., 153).

The IMF's ex-post evaluation of the Portuguese EAP is similar in that it affirms some initial headways but an overall ambiguous degree of success in the reforms, particularly with respect to the dualised labour market. It specifically underlines the pushback from the Portuguese Constitutional Court and government:

> "In the public sector, wages were reduced at first, but later reconstituted following Constitutional Court rejection. And between July 2012 and September 2013, Labor Code revisions affecting working time and employment protection were reversed [...] Deeper reforms to lower unemployment benefits and the cost of dismissals, and address the generosity of severance payments, continue to face political resistance, job protection remains among the highest in the EU, and the new jobs are disproportionately in temporary contracts." (International Monetary Fund 2016, 24)

The evidence from the ex-post evaluations of the IMF and the Commission reaffirm that, despite the uniformly deregulatory reform prescriptions given to both Greece and Portugal, the reforms ultimately implemented in practice differed to a certain degree. While both countries realised some deregulatory measures, labour market dualisation persisted, particularly in Portugal. This is reflected by the Portuguese authorities pushing back against the reform prescriptions more strongly than was case in Greece. Some reforms that were deregulatory in their prescription were reversed or changed, which mirrors the more heavily dualising nature of the reforms established by the LABREF data. Based on this evidence, H_1, a uniformly deregulatory reform prescription and implementation in both Greece and Portugal, must be rejected in favour of H_2, which accommodates different varieties of liberalising reforms in the two countries – deregulation and embedded flexibilisation in Greece, further dualisation in Portugal – due to the higher degree of discretion over the reform process retained by the Portuguese authorities.

3.4.3 Quantitative measures of labour market dualisation – status-based definition

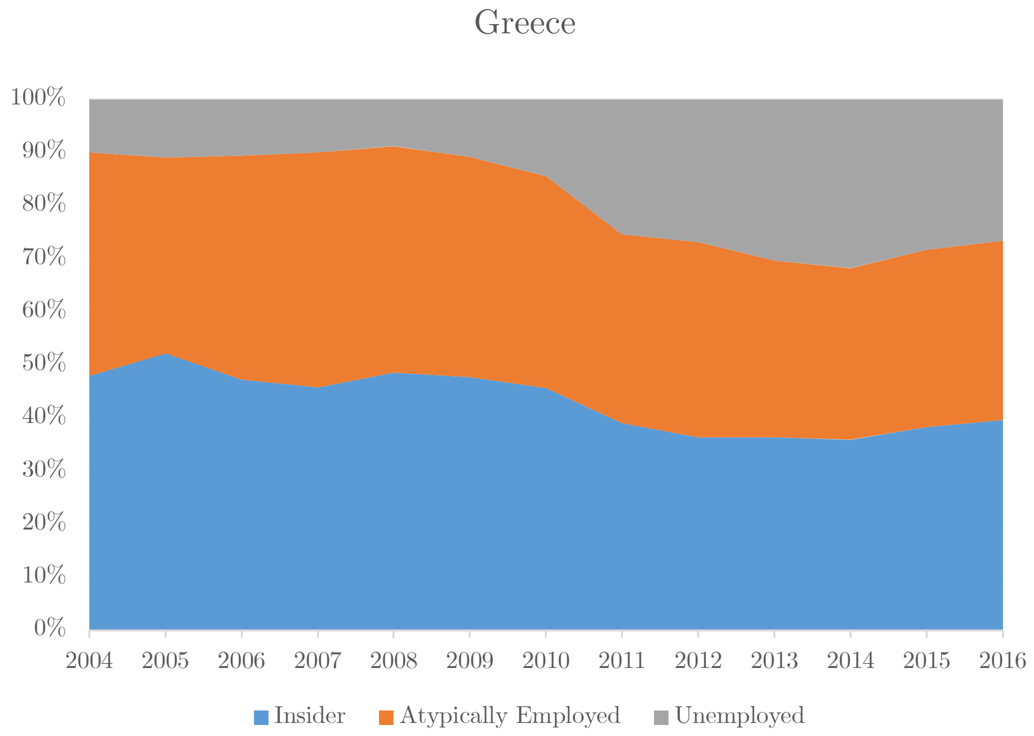
In addition to the analysis of both the reform prescriptions and the reforms ultimately implemented in Greece and Portugal, and their classification under the *Varieties of Liberalisation* framework, it is necessary to analyse the outcomes of these reforms. While there are of course difficulties in discerning the exact impact of the reform measures on the degree of dualisation in the domestic labour markets, there are a number of ways to approximate these effects, particularly with regard to the second set of hypotheses formulated in this paper. For that purpose, the paper first provides a bird's-eye view of the differences of labour market groups with regard to their affiliation with either the protected core of insiders or the more vulnerable group of outsiders. This is done in particular in order to test whether developments in the labour markets of Greece and Portugal mirror the reform efforts described in the previous sections. To recapitulate, one feature of dualised labour markets is that during a recession, outsiders will become unemployed first, thus constituting a form of buffer for labour market insiders to be shielded from the adverse effects of the recession. Under the deregulatory reforms in Greece we would expect this buffer-function to become gradually less pronounced over time. Conversely, while there was deregulation in Portugal, the substantial number of dualising reforms can be expected to uphold this buffer-function of labour market outsiders. Therefore, we would expect a relatively larger number of labour market outsiders to become unemployed vis-à-vis labour market insiders in Portugal as compared to Greece.

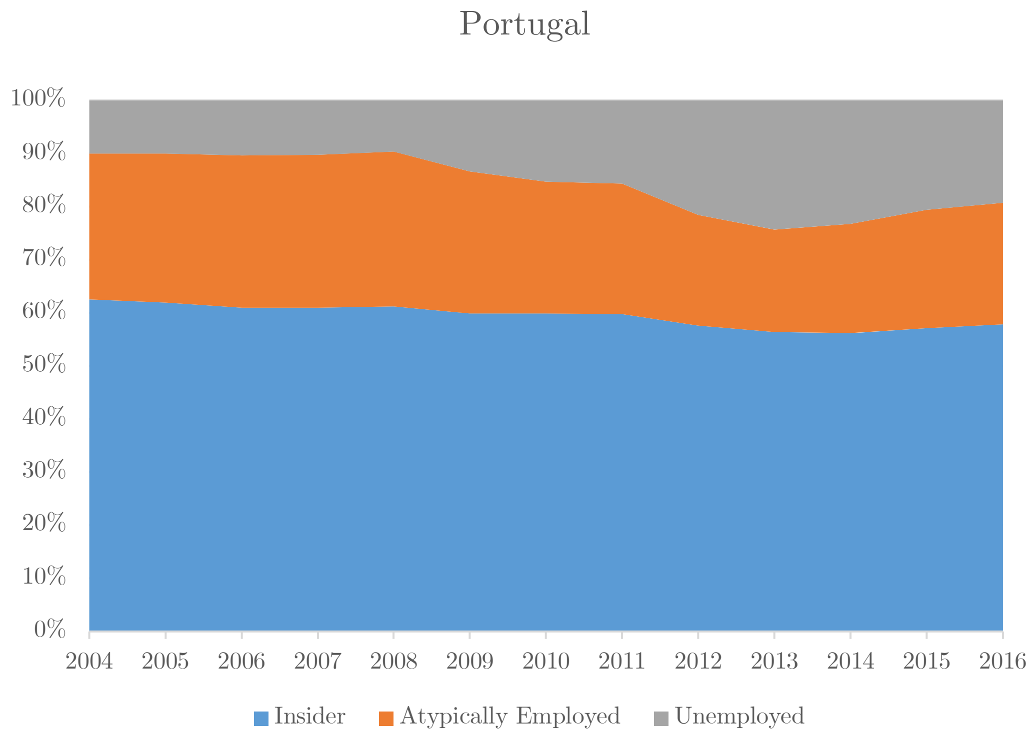
Calculating the status-based measure of labour market groups (see section 3.3.2) with cross-sectional EU-SILC data yields the following results (see Figure 24): In Greece, the number of individuals classified as labour market insiders decreased from 32.6% of the working age population in 2008 to 26.8% by 2016. The number of individuals categorised as outsiders declined by a similar rate from 28.6% in 2008 to 22.9% in 2016. Furthermore, tracing the aggregates of labour market groups in the individual years of the recession and the ensuing reform process reveals that, while overall the number of labour market insiders has declined by a similar margin as outsiders, this has not happened at consistently the same pace: In fact, after 2011, i.e. the year when the first structural reforms of the EAPs were implemented, the share of labour market insiders shrank more quickly than the share of labour market outsiders, while in the years between the global financial crisis and 2011 it was predominantly the group of labour market outsiders that contracted in the face of growing unemployment. This suggests that either labour market insiders became increasingly unemployed after having been safeguarded somewhat in the first years of the crisis, or that labour market insiders transitioned in larger numbers to atypical forms of employment, i.e. joined the ranks of labour market outsiders, while transition from outsider status to unemployment increased further.

This implies that, while in the early stages of the recession it was indeed labour market outsiders that were displaced, forming a buffer for labour market insiders, the evidence is less clear-cut in the later years of the Economic Adjustment Programmes and the structural reforms they entailed. There are two possible explanations: the first is that the sheer depth of the Greek recession after 2010 hit insiders as much as outsiders; the second is that the structural reforms of the EAPs targeted the privileges of labour market insiders, thus leaving them increasingly exposed to the effects of the recession.

The evidence for Portugal is different in that it verifies more strongly the expectations derived from the dualisation literature, as well as the observed reform trajectory from the previous sections. The total proportion of individuals classified as labour market insiders was 44% of the working age population in 2008, falling to 41.9% by 2013 at the height of the employment crisis in Portugal. In the same period, the percentage of outsiders fell more sharply from 21% to 14.3%, suggesting that, indeed, insiders were shielded to some degree from the recession through the buffer made up of the atypically employed. More importantly, between 2014 and 2016, when the Economic Adjustment Programme for Portugal had ended, the share of insiders among the working age population had bounced back to 2008 levels, while the share of atypically employed people recovered more slowly against the backdrop of slowly falling levels of unemployment. This finding suggests that structural reforms in Portugal had a much smaller negative impact on labour market insiders than in Greece.

Figure 24: Labour market groups before, during, and after the recession and reform process



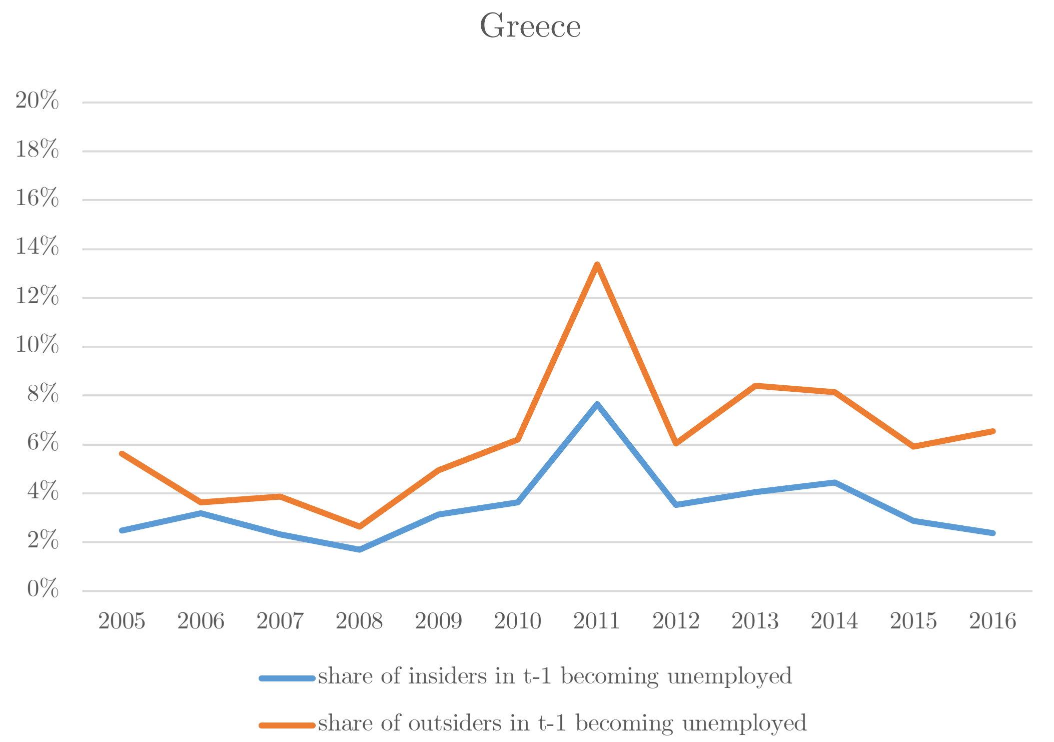


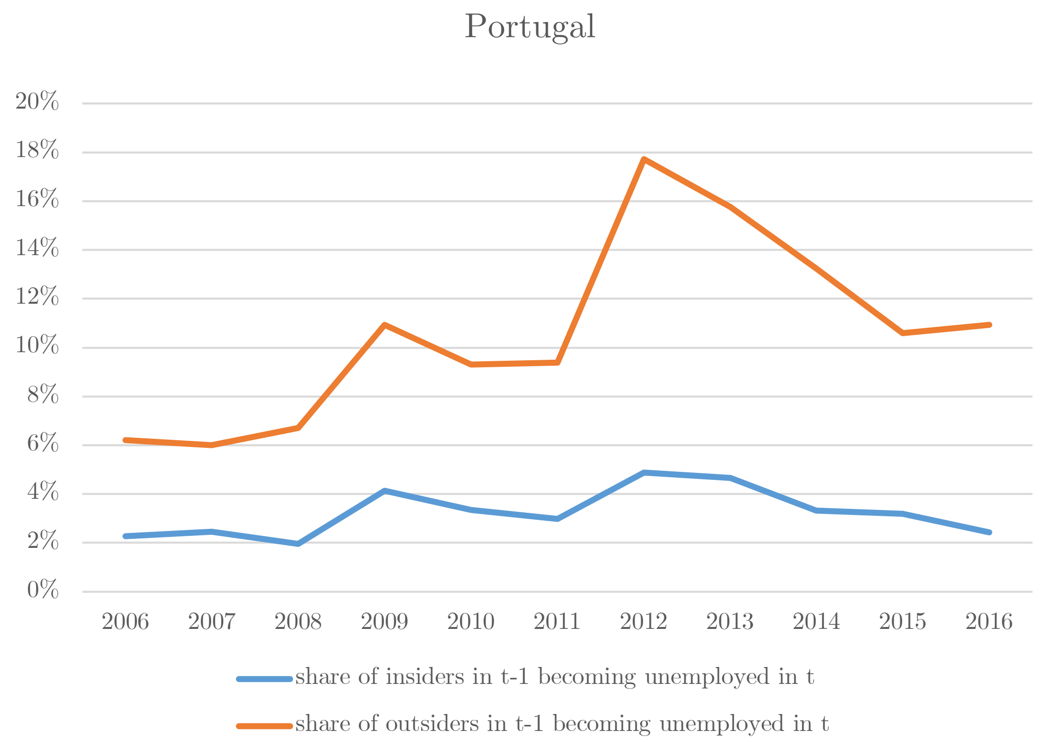
Source: Calculations with EU-SILC cross-sectional data

The findings presented above are corroborated through the analysis of labour market transitions with longitudinal EU-SILC data (see Figure 25): While the share of those classified as labour market outsiders in year *t-1* who became unemployed in year *t* in Greece rose after 2008 and was in absolute terms higher than those of insiders in *t-1* at all times, the share of insiders becoming unemployed rose by almost the same rate. This suggests that, particularly after 2010, the vulnerability of insiders to the recession rose as fast as that of outsiders. Overall, the likelihood of outsiders becoming unemployed was between 1.6 and 2.0 times as high as that of insiders throughout the crisis.

Similar to the findings presented previously, the evidence for Portugal is different from that for Greece, in that the likelihood of those classified as outsiders in *t*-1 becoming unemployed in *t* rose more rapidly than the likelihood of insiders becoming unemployed. Overall, outsiders were between 2.6 and 4.0 times as likely to become unemployed as insiders throughout the crisis (see Figure 26). In other words, the vulnerability of labour market outsiders during the recession, as measured by the group-specific risk of becoming unemployed, was substantially higher than that of insiders.

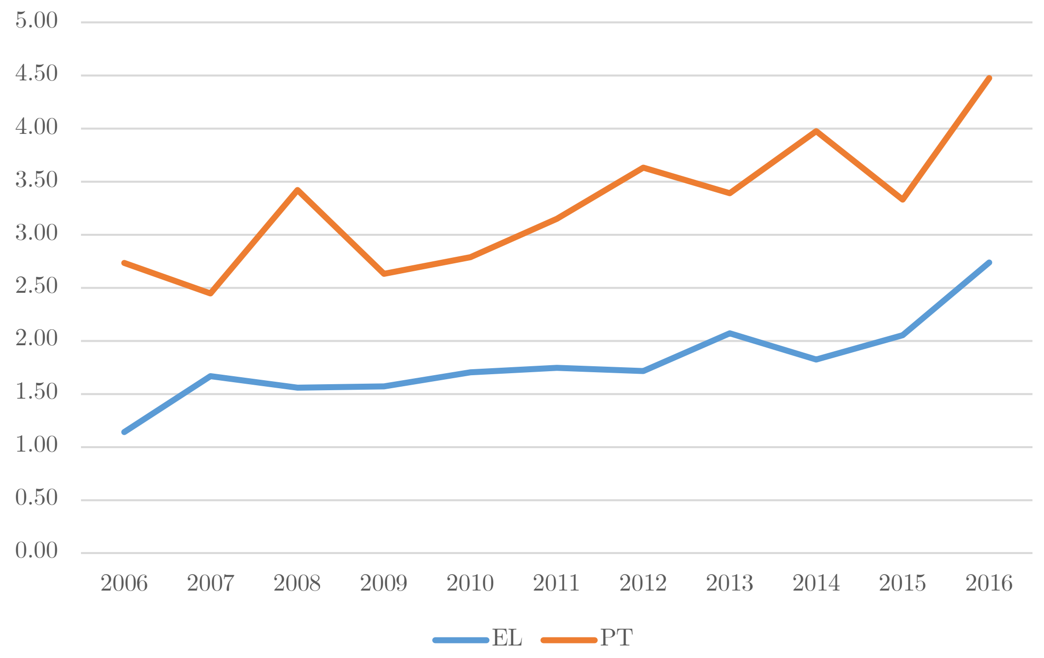
Figure 25: Labour market transitions from insider/outsider status in t-1 to unemployment in t





Source: Calculations with EU-SILC longitudinal data

Figure 26: Ratio of group-specific risk of unemployment for labour market outsiders by group-specific risk of unemployment for insiders



Source: Calculations with EU-SILC longitudinal data

Notes: A value of e.g. 3.0 denotes that in the corresponding year labour market outsiders' probability of becoming unemployed was three times as high as that of insiders.

In light of this evidence, H_3 clearly has to be rejected in favour of H_4: Labour market outsiders continually constituted a buffer shielding insiders from unemployment in Portugal, as evidenced by outsiders' conspicuously higher risk of becoming unemployed. Together with the evidence provided in the previous sections, this suggests that labour market dualisation persisted in Portugal due to a number of reforms taking on a distinctly dualising trajectory, thus leading to a further deterioration of employment conditions for outsiders, while doing relatively less to retrench the protected position of labour market insiders. Conversely, in Greece, labour market insiders displayed similar increases in group-specific unemployment risk to outsiders throughout the recession. This suggests that the buffer function of labour market outsiders was limited. The evidence from the LABREF data as well as the ex-post evaluations of the Greek EAPs by the European Commission and the IMF suggest that this is at least in part due to the nature of the reform measures imposed by the Troika following patterns of deregulation and embedded flexibilisation.

3.5 Conclusion and Avenues for Further Research

This paper analysed different trajectories of labour market reforms in the Eurozone crisis, drawing on both Thelen's *Varieties of Liberalisation* framework (2014) and insights from the dualisation literature (Rueda 2005; 2006; 2007; 2014; Emmenegger et al. 2012; Schwander and Häusermann 2013), as well as explaining different outcomes for those classified as labour market insiders and outsiders. The analysis focused on the two cases of Greece and Portugal. The two countries were chosen in particular due to the fact that the reforms were not devised by domestic governments alone but by the supranational, technocratic policy-makers of the Troika.

The central argument of the paper is: due to technocratic policy makers not being subjected to the same pressures as office-seeking politicians in the way they design policies, they follow a fundamentally different logic. Rather than being governed by considerations about which electoral groups they need to respond to, technocratic policy makers seem to follow what they deem good economic policy. In the particular case of the Troika with regard to labour market reforms, it is clear that all three institutions follow the liberalisation paradigm prominent in virtually all advanced capitalist democracies since the 1980s (Streeck 2011) and the turn from Keynesianism to Monetarism (Hall 1993). Given the stipulations of this paradigm, the key element of Troika-style labour market reforms was flexibilisation.

In the particular cases of Greece and Portugal, this entailed an emphasis on breaking up the privileges of highly protected labour market insiders in order to lower the degree of dualisation in these labour markets, which the Troika institutions diagnosed as an inefficiency and therefore a barrier to economic growth. The domestic governments in the countries on the other hand have in the past contributed to the cementation of labour market dualisation through concrete legislation which strengthened the protection of the core workforce while leaving employment conditions for those on the fringes, such as temporary workers, to deteriorate further.

Taking one key insight from Paper 2 of this thesis, namely that the Troika maintained a tighter grip on the reform process in Greece than in Portugal, and that the Portuguese authorities pushed back more effectively against the Troika reform prescriptions, the paper juxtaposed the reform measures in the two countries at different stages. Firstly, an analysis of the EAPs yielded that the reform prescriptions at the onset of the adjustment process were largely similar in both countries. Focusing on both lowering coordination and coverage, the reform prescription can be labelled as deregulatory as stated by Thelen's *Varieties of Liberalisation* framework. Secondly, the paper used evidence from the LABREF database to test whether the reform measures eventually implemented in practice in the two countries matched those of the EAP prescriptions. While both countries seem to have followed through with some of the deregulatory reform measures, there were some departures from the original reform prescriptions. A number of the reforms followed the pattern of embedded flexibilisation, i.e. lowering the degree of coordination but not coverage of labour market institutions. With regard to the dualisation of labour markets, embedded flexibilisation reforms can be expected to have an equalising effect given that labour market insiders ordinarily benefit more strongly from coordinating institutions than outsiders. Conversely, unlike the reforms in the more strongly controlled and micro-managed Greece, almost half of the flexibilising reforms in Portugal targeted labour market outsiders, thus leading to a further compounded dualisation of the labour market. This was reflected in the Troika institutions' ex-post evaluations of the EAPs, which detailed that, despite a general slowdown of the reform progress in both countries, overall compliance with the course set by the Troika was higher in Greece than in Portugal, where labour market dualisation was found to have largely persisted.

These differences in the implemented reforms are mirrored in labour market outcomes measured for both labour market insiders and outsiders. Using status-based operationalisations following Rueda (2007), and drawing on both cross-sectional data at individual points in time and longitudinal data tracing individuals across several years, the analysis has shown that, indeed, in the case of Greece, the degree of labour market dualisation fell. Similarly, the same was not found to be true in the case of Portugal, where labour market reforms followed a more dualising route. This is evidenced by a higher risk of unemployment for labour market insiders through the duration of the EAPs in Greece, while they remained largely shielded from unemployment throughout the crisis in Portugal. Conversely, labour market outsiders were hit disproportionately harder than insiders in Portugal, while they displayed the same increases in unemployment vulnerability as insiders in Greece.

These findings allow for the conclusion that the same dynamics observed for fiscal reforms in the previous papers of this thesis also apply to the realm of labour market reforms: In the more strongly Troika-controlled EAPs for Greece, fiscal reforms had an equalising effect, resulting in larger income reductions for higher income groups, while shielding or even compensating lower income groups. This was found to be due to technocratic policy makers being able to implement politically thorny reforms that elected governments would otherwise skirt around for fear of retribution at the ballot box, such as lowering pensions for higher income households. Labour market reforms had a similar effect in that they targeted the group of hitherto well-protected insiders, resulting in an equalisation of the labour market, although imbalances persisted in the Greek case, too. Conversely, fiscal reforms in Portugal were found to protect those in the middle of the income distribution, which constitute important groups of median voters around which powerful electoral coalitions can form. Portuguese labour market reforms followed a similar trajectory to a certain degree, with the domestic government attempting to steer some of the adjustment burden away from labour market insiders, which likewise comprise important voter groups following the dualisation literature.

However, there is one important difference pertaining to the distinctive underlying dynamics governing the actions of unelected technocrats on the one hand and elected, office-seeking ones on the other hand: While fiscal reforms in Greece were found to be intentionally compensatory for lower income groups, there is no evidence whatsoever that similar reforms were implemented to improve employment conditions for labour market outsiders. In fact, labour market reforms in Greece were largely either deregulatory or following embedded flexibilisation, suggesting that while labour market insiders saw the largest reductions in the degree of protection from unemployment and a decrease in other beneficial employment conditions, labour market outsiders' employment conditions deteriorated, too, albeit at a slower pace. Therefore, while overall labour market inequality decreased as a result of the reforms, this was clearly in an overall downward direction. In other words, greater equality was achieved by making everybody worse off, but insiders more so than outsiders.

While this underscores that the reforms imposed by the Troika were painful, it also reaffirms the argument posited in the previous papers that technocratic policy makers are primarily governed by their ideas of what constitutes good economic policy. In that sense, as presented in Paper 1 of this thesis, there is evidence of an ideational shift in the economic orthodoxy leading technocratic institutions such as the IMF to advocate for policies that increase redistribution towards lower income groups as this is seen as a growth-enhancing tool. However, with regard to ideal-type labour market reforms, there is no evidence of such a shift having taken place. Instead, institutions like the IMF, but also the European Commission, continue to operate under Washington-Consensus-style principles of flexibilisation as the dominant mantra of labour market reforms. Compensation for more vulnerable groups, such as increasing the level of protection for temporary workers or the otherwise atypically employed, is not part of this consensus. In fact, the same group of IMF-researchers that produced a number of reports pointing out the negative relationship between high inequality and long-term economic growth, and belying the existence of an equity-efficiency trade-off for the formulation of sensible redistributive fiscal policies, find in relation to structural reforms that such equity-efficiency trade-offs are still at play (Ostry, Berg, and Kothari 2018). This highlights that the absence of electoral pressures for policy makers can have equalising outcomes, as shown for the case of fiscal policy reforms, but that this depends crucially on whether the set of economic ideas governing technocratic policy makers' actions accommodate compensatory measures for more vulnerable groups.

In future research, the paper's findings can be tested further by tracing more closely the preferences of office-seeking policy makers with regard to labour market reforms using methods such as those devised by Bürgisser and Kurer (2019). This would allow more detailed inferences to be drawn as to how and why the reform prescriptions of the Troika were altered in the implementation stage, thus leading to a more dualising effect. Similarly, the paper's key assumption that office-seeking politicians are more likely to implement reforms that guard labour market groups perceived as important to their re-election endeavours can be tested for other country-cases outside of the control of the Troika. There are, however, some first results pointing in the same direction, demonstrating that e.g. labour market reforms in Italy and Spain followed divergent trajectories despite large similarities between the two countries, likely stemming from the responsiveness of the respective governments in power to different voter groups (Picot and Tassinari 2017).

Conclusion

B.1 Overview

The bailout agreements and accompanying economic adjustment packages loaned to the Eurozone's debtor countries of the last decade's Eurozone crisis presented a unique opportunity for the analysis of the consequences of such programmes along two key dimensions for borrowing economies: (i) income inequality, and (ii) labour market segmentation. Sweeping reform directives constituted the conditionality for financial assistance by the Troika of unelected, non-government bodies, namely the IMF, the European Commission, and the ECB. Nevertheless, the policy reforms that were brokered in exchange for the funds were to be implemented at the national-level by domestically elected government actors, marking the interplay between elected and unelected policy makers as a key issue to understand the various distributive effects of the reforms.

Two of the bailout programme recipient countries requiring some of the most drastic restructuring during the Eurozone crisis were Greece and Portugal. The reforms' effects on income inequality and job market segmentation in these two economies are a pertinent development to analyse, as they constitute "most similar systems" cases, giving rise to the expectation that inequality and labour market trends subsequent to the reforms should not be radically varied. Although in theory the reform policies were laid out and negotiated between the debtor member states (Greece and Portugal) and the three Troika institutions, in practice this was not honoured because of two variations between the countries. Firstly, due to the emergence of differing degrees of administrative resources and implementation capabilities between these two countries, and secondly, as a result of the much more critical state of the public balance sheet in Greece, the Troika de facto assumed a much more proactive, zealous role in conditionality reform-implementation in Greece compared to Portugal.

In this context, the thesis analysed in detail the distributive effects of the reforms prescribed through the economic adjustment programmes for Greece and Portugal, using a mix of qualitative and quantitative methods. One of the most important contributions made in this thesis is shedding light on the issue of the interplay of democracy and technocracy with inequality in the face of austerity and labour market liberalisation. The thesis found stark differences in how unelected technocrats on the one hand and elected, office-seeking politicians on the other hand make decisions regarding redistributive policies. The former seem to be governed mainly by their ideas about what constitutes good economic policy and, importantly, are at liberty to implement policies accordingly without fear of retribution at the ballot box. This can have unexpected progressive effects as technocrats can for the most part ignore vested interests and for instance redistribute away from important voter groups towards those most in need of it, as is evidenced by the fiscal reforms in Greece. It can, however, also have rather brutal effects for even the most vulnerable, as is evidenced by the observed labour market reforms in Greece, which – although specifically targeting the privileges of labour market insiders, too – had almost unidirectionally deregulatory effects, thus further exacerbating dire employment conditions of labour market outsiders in the short run.

Reversing this argument, the thesis also makes an important contribution to our understanding of democracy and inequality: Far from being rigged against everyone but the super-rich (as parts of the current public discourse suggest), capitalist democracies seem to be remarkably aligned with the interests of the middle class, as is evidenced by both fiscal and labour market reforms in Portugal. However, this also showcases that more vulnerable groups (be they lower income households or labour market outsiders) do not necessarily benefit from the alignment of policies with middle class preferences, as is illustrated by the reform effects in Portugal (see also Iversen and Soskice 2019). The following summarises the findings presented in the thesis, highlighting its key contributions.

B.2 Main findings and contributions

B.2.1 Paper I

The first paper analysed the distributive effects of the EAP reforms in Greece and Portugal in aggregate terms, motivated by the idea of testing the predictions made in the economic literature stating that fiscal consolidation leads to higher inequality (Agnello and Sousa 2014; Ball et al. 2013; Woo et al. 2013). Using first descriptive statistics and EU-SILC microdata, the paper shows that inequality stagnated rather than increasing throughout the entirety of the reform programmes. In the face of rising levels of market income inequality, this suggests that the redistributive capacities of the welfare state were left intact despite the cuts in social expenditure.

Using microsimulations, the paper then showcased that the reforms of the EAPs were in fact directly responsible for these developments. Compared to a hypothetical, non-reform counterfactual scenario, the actually implemented reforms had an inequality-reducing effect. This constitutes a completely novel finding on the basis of so far unused data sources for the purposes of this thesis. Furthermore, the paper tested the literature's assertions that the composition of austerity is crucial for its distributive effects (Alesina and Perotti 1995;

Alesina, Favero, and Giavazzi 2019; Ball et al. 2013; Woo et al. 2013). Again, making use of microsimulation tools and decomposing the distributive effects of the reforms by policy classes, the paper finds that this is untrue. The most inequality-reducing reforms in Greece were expenditure-based, which is contrary to the findings in the economic literature. Moreover, the paper shows that the exact design of the reforms, rather than their composition is crucial for determining their distributive effects. For instance, reforms of the same class were found to be progressive in Greece and regressive in Portugal.

On the basis of this empirical analysis, and to explain the somewhat unexpected findings, the paper outlines the preferences of the Troika policy makers regarding inequality and redistribution. In the past, technocratic institutions such as the IMF have been found to champion distinctly market liberal reforms with detrimental effects for income inequality. However, the paper shows based on the analysis of EAP-related documents, research publications by the IMF, speeches, and secondary interview data that the Fund has undergone an ideational shift. Inequality is increasingly seen as a problem for economic growth by the Fund, and, in a departure from the oft-cited equity-efficiency trade-off, policies to alleviate inequality are at the same time increasingly viewed as valid instruments. This is due to both the necessity to ensure public support in order to be able to successfully implement growth-enhancing reforms, and the view that redistributive policies are conducive to economic growth in their own right (Berg and Ostry 2011; Ostry, Berg, and Tsangarides 2014; Lipton 2013). This in turn is based on the Kaleckian view that lower income households have a higher marginal propensity to consume and that redistributing towards them therefore has higher multiplier effects in stimulating aggregate demand and thus economic growth. For the case of the European Commission, the paper presents evidence that the Commission is in fact in favour of a more regulated form of capitalism and more redistributive policies in support of a European social model (Hooghe 2000; 2001; Ross 1995; 2011).

B.2.2 Paper II

The second paper took up the findings from the first paper with the aim of explaining the differences between the distributive effects of the Greek and Portuguese EAPs which can be observed when zooming in on the income distribution and analysing income changes by decile rather than in aggregate terms. The paper provides a more detailed comparative case study of Greece and Portugal in order to identify independent variables that are able to explain this variation. Whilst both countries are found to be similar along all relevant variables, the major difference that emerges is the degree of control exercised by the Troika.

The paper presents evidence that the Troika's grip on the reform process was considerably tighter in the case of Greece than in the case of Portugal. The paper argues that this is due to the lower reform implementation capacity of the Greek state on the one hand, which required firmer Troika control, and the stronger veto points in the Portuguese case on the other hand, which made Troika interference on the specific reform design more difficult. This was exacerbated by Portugal's early return to the long-term bond markets, ending the dependence on the Troika payments. The paper presents evidence that the observed reform effects are thus more in line with the preferences of the Troika in the case of Greece, and with the preferences of the elected government in the case of Portugal.

The argument is confirmed by the observation that the reforms became appreciably more progressive in Greece from 2012 onwards, which is the point in time where the Troika reined in the reform process and began to micromanage the Greek government, issuing specific reform prescriptions rather than more general fiscal targets. In the case of Portugal, the paper tests for different manifestations of the voter responsiveness argument, showcasing that the government sought to shield those voters in the middle of the income distribution, which is reflected by the reform effects. This is because powerful electoral coalitions form around the median voter (Downs 1957; Meltzer and Richard 1981; Iversen and Soskice 2006); responding to the median-voter preferences is thus in line with the interests of re-election seeking politicians. The findings of the paper contribute to the debate on the interplay of democracy and inequality, specifically with regard to the burgeoning literature on whether democratic capitalism is rigged and only serves the rich (e.g. Bartels 2018), or whether it serves instead primarily the interests of the middle class (e.g. Iversen and Soskice 2019), a view which the findings of this paper support.

B.2.3 Paper III

In the third paper, the analysis turned to another manifestation of inequality, namely labour market dualisation. On the basis of the previous two papers, the thesis tested whether the impact of the different degrees of Troika involvement in the two countries would extend to the realm of labour market reforms and, if so, whether the effects were in a similar direction. For this purpose, the paper utilises insights from the labour market dualisation literature (see e.g. Rueda 2005; 2006; 2007; Ebbinghaus 2006; Emmenegger 2009; Emmenegger et al. 2012; Häusermann and Schwander 2012; Iversen and Soskice 2009). This literature postulates that labour market inequality, whilst intensified by structural pressures (Autor, Levy, and Murnane 2003; Autor, Katz, and Kearney 2006; Rodrik 1998; Iversen and Cusack 2000; Iversen and Wren 1998; Oesch 2006), is more often than not the product of concrete legislation. This in turn is due to the fact that labour market insiders, i.e. those in secure and stable forms of employment, are perceived as more essential to the re-election of office-seeking politicians than labour market outsiders, whose preferences often diverge from those of insiders.

Following this, the paper tested whether the same logic that led to more progressive fiscal policy reforms by eliminating the need for policy makers to cater to certain voter groups (see reform effects in Greece post-2012), also applies in the realm of labour market policies. Extending this logic, labour market reforms of the Troika-controlled Greek EAPs should be more equalising and less centred around the interests of insiders than the reforms in Portugal. Using evidence from the LABREF database and Thelen's *Varieties of Liberalisation* (2014) framework, the paper finds that this is corroborated to a certain extent. Reforms in Portugal were indeed found to be more dualising than those in Greece, which were found to follow both trajectories of embedded flexibilisation and deregulation. This is reflected by the reform effects on labour market outcomes, with insiders becoming noticeably more vulnerable in Greece but not in Portugal. However, one important caveat is that in contrast to the fiscal reforms in Greece, labour market reforms did not incorporate any compensatory elements for the most vulnerable. Therefore, whilst technically equalising, the reforms made everybody worse off, although hitting insiders relatively harder.

Whilst this constitutes an important difference vis-à-vis the fiscal reform logic, it confirms the argument made throughout the thesis that the technocratic policy makers are governed less by interests to cater to important voter groups (be that in terms of income groups, or labour market groups), but by their ideas of what constitutes good economic policy. In the realm of structural reforms, the dominant orthodoxy still centres around the wholesale liberalisation of labour markets, whilst subscribing to the view that more vulnerable workers would benefit in the long run from the undoing of insider privileges, which constitute entry barriers for labour market outsiders from attaining more stable types of employment.

B.3 Theoretical Discussion: A case for actor-centred institutionalism?

The three papers of this thesis are all connected by two common themes: (1) Policies that are not ordinarily associated with progressive outcomes, such as austerity measures and labour market reforms, are shown to have progressive effects in the context of the Economic Adjustment Programmes in the Eurozone crisis; (2) Technocrats seem to have been able to implement such progressive reforms better than their elected counterparts in the domestic governments. This insight informs our debates on the politics of redistribution in a narrow sense, and the politics of advanced capitalism in a wider sense. In recent years, the fields of political science and political economy have been undergoing what Beramendi et al. (2015) call an 'electoral turn'. Essentially, this stipulates that governments are primarily beholden to the interests of voters, although they are constrained by various elements of demand and supply side politics.

This model of constrained partisanship is immensely intuitive and attractive in explaining the politics of advanced capitalism. However, most research since then seems to have focused exclusively on what voters want and how governments respond to that, leaving aside the role of institutions. This may be a mistake. In particular, as this thesis has shown, elected policy makers may not just be constrained by the direct will of the voters but especially by the will of voters expressed in past rounds of policy making and enshrined in institutions. These are, as we know for instance from the work of Paul Pierson (2001) resilient and difficult to change. This brings up the question how well an almost exclusive focus on electoral politics is suited in explaining change, which is, after all, one of the key enterprises in political science. As shown in this thesis, elected policy makers are often more constrained by either voters or by institutions (see e.g. the case of the Portuguese pension reform) than they are at liberty to enact progressive reforms as part of their accountability to the electorate. In the undoubtedly valuable effort to better understand the dynamics of electoral politics, political scientists should, therefore, not lose sight of the importance of institutions, as Pierson (2016) also points out in a review of Beramendi et al.'s work.

In fact, this thesis has touched upon the notion of institutional change several times and will at this point elaborate further on the notion. On the one hand, the thesis has shown a number of important instances of institutional change with regard to the redistributive capacities of the welfare states of the two country cases analysed here. On the other hand, the thesis has argued repeatedly that the impact of the Troika in facilitating that change was in itself an expression of institutional change within the Troika bodies, and most notably the IMF and the European Commission. After all, neither the IMF nor the Commission have in the past been associated with being champions for more redistributive and progressive policies. In explaining this puzzle, the thesis at this point draws on important theories of institutional change (most notably Mahoney and Thelen 2010), as well as important applications of these theories such as the one provided by Ben Clift (2018) in the context of the IMF. On that basis, the thesis formulates a critique of puristic forms of historical institutionalism in favour of a revival of what Renate Mayntz and Fritz Scharp have called actor-centred institutionalism (Mayntz and Scharpf 1995; Scharpf 1997). The thesis has presented evidence for two important arguments: Actors matter, and ideas matter. In fact, individual actors seem to have been the driving force behind the institutional change we have observed in the IMF, and the even more gradual change in the Commission. In turn, these actors are shaped substantially by their ideas regarding what is good economic policy or how the economy should be structured in general.

Fritz Scharpf summarises the essence of the argument developed in what follows in his work on actor-centred institutionalism originally formulated with Renate Mayntz:

> "We must remain aware of the fact that although institutions constitute composite actors, create and constrain option, and shape perceptions and preferences, they cannot influence choices and outcomes in a deterministic sense. Institutionalised rules, even if they are completely effective, will rarely prescribe one and only one course of action. Instead, by proscribing some and permitting other actions, they will define repertoires of more or less acceptable courses action that will leave considerable scope for the strategic and tactical choices of purposeful actors." (Scharpf 1997, 42)

To reiterate the example given in the thesis, what does this mean in terms of the change observed in the IMF's position on inequality and redistribution? On the one hand, it is clear from the evidence presented above that agents played a central role in this shift: research carried out by senior IMF staff such as Jonathan Ostry, deputy director of the IMF Research Department, and colleagues laid the groundwork for the Fund's shift in its views on inequality and redistribution. Moreover, as recent research by Clift (2018) who conducted numerous interviews with senior IMF staff shows, this was preceded and facilitated by changes in the IMF leadership: The tenure of Dominique Strauss-Kahn as IMF Managing Director between 2008 and 2011 marked the inception of this gradual shift in the IMF's view on inequality, the legacy of which was carried on by Strauss-Kahn's successor Christine Lagarde. The promotion of Olivier Blanchard and Carlo Cottarelli, both proponents of New Keynesian economics and receptive to the notion of inequality being a central issue in economy policy making, to IMF Chief Economist and Director of the Fiscal Affairs Department respectively marked another key point that accelerated this institutional shift. Arguably, Maurice Obstfeld who succeeded Blanchard in 2015 followed similar economic ideas, thus ensuring a continuation of the IMF's gradual change. On the other hand, this also shows that ideas play a major role in informing institutional change as they structure the way in which change-agents view the world and ultimately define their interests (Blyth 2002; Hay 2002). In the case at hand, the specific ideas of key IMF figures on how the economy works formed the basis for the shift in the IMF's position on inequality and redistribution.

However, one of the key insights of the new institutionalist literature and a progression from overly agent-centred behaviouralist approaches is that the relationship between institutions and agents is at the very least a reciprocal one. Therefore, even though agents play a key role in shaping institutional change by interpreting their assigned roles in particular ways, their behaviour is in turn structured substantially by institutions. Our theory on non-majoritarian institutions and inequality must strike a balance between the two and accommodate this reciprocal relationship of ideas, how they translate into interests, and shape actors' behaviours with regard to institutional change, and vice versa, how institutional configurations shape actors' interests as well as the ideas through which they make sense of the world (Hall 1989; Steinmo and Thelen 1992). Therefore, we need to first ask which ideas are most prevalent among agents within the institution and how the institution acts as a filter for certain ideas. Next, our analysis needs to look at how these ideas are ultimately translated into rules and thus shape the institution, taking into account the reciprocal relationship between agents and their institutional environment. Finally, how are these ideas enacted, or in other words, how do these institutionalised ideas translate into actual policies?

In answering the first of these questions, the evidence shown in the thesis has addressed the common perception that institutions such as the IMF are beholden to a certain ideology when it comes to economic policy. The IMF, in particular, has been described as following neoliberal doctrine (Peet 2009), which in turn has been found to be reflected in the economic ideas of IMF staff and policies prescribed to creditor countries, most notably since the 1980s and into the 2000s (Nelson 2014). However, research on the politics of ideas and knowledge in international organisations shows that this is at the very least an oversimplification of a much more complex reality. The IMF's self-conception in this regard is that of an apolitical, pragmatic institution (Clift 2018). Economic policy, through this lens, is not an exercise in promoting or following any particular ideology, but a purely technical one (Best 2005), a principle that has for decades been central in the IMF's organisational culture (Barnett and Finnemore 2004; Momani 2007). Of course, self-conception and organisational culture on the one hand and reality on the other are not necessarily congruent. However, the thesis has shown that analysing major IMF publications such as the *World Economic Outlook* reveals that rather than obeying doctrine, Fund staff simply follow the respective status quo in the economics profession at a given time. Economic ideas will be taken up by the Fund if they are legitimised through cutting-edge research at top economics departments, regardless of whether these ideas represent established schools of thought or challenge them (Ban and Patenaude 2018).

A dispute between orthodox and revisionist understandings of economics is usually reflected in the IMF's position on certain topics rather than promoting one or the other. The fact that economic policies advocated by the IMF overlapped with neoliberal principles for the better part of two decades since the 1980s is thus more of a reflection of the then consensus in the economics profession after the turn to neoclassical economics rather than a sign of ideological fealty in its own right. More specifically, the research shows that, aside from the fact that economics itself is never completely free from ideological elements about how the economy should work, which in turn form the basis for assumptions upon which theoretical models rest (e.g. Blaug 1996), IMF staff are not beholden to any one economic doctrine in particular due to their institutional affiliation. Similarly, whilst IMF economist are inevitably shaped by their academic, and potentially ideas-based, training, their role in day-to-day work dictates that they consider practical considerations much more than is the case in academic research in the field of economics. Rather than aligning with ideological doctrine, the IMF, particularly in its own self-conception, seems to follow the principle of 'sound economic policy' as well as trying to shape how exactly this notion is interpreted (Clift 2018).

Answering the second question, how ideas translate into rules shaping the institution, leads to a more in-depth discussion of both the IMF's self-conception and how this affects the way in which ideas prosper within the Fund. The self-defined concept of an apolitical, technocratic institution dictates a certain degree of open-mindedness when it comes to different economic ideas and promotes competition among them. In fact, the IMF is much less homogenous than previous accounts argued (Blyth 2003; Grabel 2003). Rather than uniformly advocating a particular set of ideas, the IMF is characterised by internal struggles among different ideas and subcultures that promote one or the other before (as well as after) they are formalised and ultimately find their way into actual policy prescriptions (Chwieroth 2009; Ban 2015). This is evidenced both in interviews with Fund staff (Clift 2018; Ban and Patenaude 2018), official documents published by the IMF (Ban 2016), and public statements made by Fund officials. The notion of internal competition among different economic ideas is illustrated in the way Fund officials referred to the rules of the Washington Consensus – often incorrectly put forward as the IMF's sole guiding principle – by the early 2000s, i.e. still before the change in the IMF's position on interventionist economic policies and particularly redistribution had accelerated in the wake of the GFC and with the appointments of Dominique Strauss-Kahn, Olivier Blanchard and others. In

2004, then-Deputy Managing Director Anne Krueger in analysing economic challenges and policy failures in Latin America since the 1990s spoke of policy makers having "meant well, tried little, failed much" with regard to progress on Washington-Consensus-type reforms. Whilst Krueger was clearly advocating for 'more of the same' and pushing for further Washington-Consensus-type reforms, even the IMF's own Evaluation Office at the same time produced reports arguing the opposite with regard to the efficacy of such reforms, showing that even in the heyday of neoliberalism there was never really one particular set of economic policy ideas that the IMF promoted exclusively (Rodrik 2006).

With regard to our understanding of gradual institutional change this further illustrates that, rather than acting as external shocks leading to abrupt change, the mechanism here lies in how events such as the GFC empower certain subcultures within institutions. This in turn allows some ideas to become more prevalent than others, which then forms the basis for institutional change. The key insight that is stressed here is that institutional change, whilst often facilitated by such events, is ultimately driven by change-agents within the institution. Such change-agents make use of 'soft spots' (Mahoney and Thelen 2010) that allow them to exploit rule ambiguity or imprecision by interpreting reality in new ways, thus ultimately reshaping the institution. The argument I put forward here is that the way in which we should conceive of this process revolves around the concept of 'situated agency'. As Hall and Taylor put it in their seminal work: "Not only do institutions provide strategically-useful information, they also affect the very identities, self-images and preferences of the actors" (1996). In that sense, change-agents, despite being the driving force of gradual institutional change, never operate in a vacuum and are always beholden to their own economic ideas. The concept of situated agency thus offers one possible solution to what Hall describes as the problem of 'explaining how institutions that are to some extent plastic can nonetheless contribute to the structuring of the political world' (Hall 2016a). Acknowledging the central importance of agents, the appeal of this notion is the following: Instead of giving primacy to either the ideas that agents hold or the institutional context in which they operate (cf. Hay and Rosamond 2002), situated agency assumes dialectical interactions of agents and their ideas on the one hand and their institutional environment and how this shapes their ideas on the other hand (Bell 2011; Marsh 2009). Both ideas and institutions thus become somewhat fluid concepts that evolve and reshape each other dialectically through situated agency at its centre.

The third question posed earlier, how institutional change is reflected in actual policy prescriptions, can be answered in the following way. Given the central role of situated agency and the dialectical relationship of ideas and institutional environments, it becomes clear that the rather novel-seeming policies advocated by the IMF regarding interventionist economic policies and redistribution, are otherwise in line with our understanding of how institutions like the IMF work: Once a newer set of ideas has taken hold within the institution, or indeed an older but less prevalent set of ideas has superseded previously dominant ideas, and is legitimised through research both from within and outside the IMF, they rather quickly translate into policy prescriptions. The IMF in particular is an extremely hierarchical institution (Copelovitch 2010; Momani 2007), and as such gives change agents in senior positions the power to facilitate the diffusion of these ideas so that they are reflected in the policy prescriptions given out by the Fund (Clift 2018).

Therefore, the sequence of institutional change at the IMF that ultimately led to the prevention of excessive levels of inequality becoming a policy priority can be made sense of in the following way: Both the IMF's self-conception as an apolitical institution and the central role of situated agency form the basis for the competition of ideas within the institution. Events such as the GFC can in this regard indeed act as catalysts for some ideas to prevail over others particularly when they challenge the contemporaneous orthodoxy. Such ideas take hold only when they are legitimised through cutting-edge research by top economists both within and outside the institution. To illustrate this, we can see that at the time influential economists such as Alan Auerbach, Larry Summers, and others (see e.g. Auerbach and Gorodnichenko 2012; DeLong et al. 2012) moved away from their previous positions in their analysis of the GFC and towards more market scepticism and openness to interventionist policies. This break with the orthodoxy by some of the world's top economists precipitated the IMF becoming more sensitive towards these issues (Clift 2018). At the same time, a growing body of research on the causes and levels of economic inequality spearheaded by scholars like Tony Atkinson, Thomas Piketty, Emmanuel Saez and collaborators gave more salience to the issue of economic inequality within the economics profession as a whole (e.g. Piketty and Saez 2003). Research from within the IMF mirrored this development both with regard to a generally more market sceptic view of economic policy (Cottarelli and Jaramillo 2012) and the issue of inequality as an impediment to sustainable long-term growth (Berg and Ostry 2011; Ostry, Berg, and Tsangarides 2014). Internally, this process was driven forward by change-agents such as Dominique Strauss-Kahn, Olivier Blanchard, and others. Once this ideational shift was under way, concerted efforts by these powerful change-agents saw to the diffusion of the new ideas within the Fund. Ultimately, the hierarchical, top-down organisational form of the IMF allowed these ideas to quickly translate into actual policy prescriptions, which was at the time for instance reflected in the Economic Adjustment Programmes in the Eurozone crisis.

Through an institutionalist lens, we can make sense of this process of gradual institutional change as a combination of layering, i.e. the introduction of new rules on top or alongside existing ones (Mahoney and Thelen 2010; Streeck and

Thelen 2005), and conversion, i.e. the process of agents interpreting existing rules in a new way (Thelen 2004). This is clear from the fact that, firstly, the issue of inequality was given a much higher priority on the IMF's agenda and became the subject of closer investigation both with regard to past IMF policies and the likely impact that future IMF policies would have on inequality (layering). Secondly, the role of more interventionist policies, and in particular redistribution, was reinterpreted by agents within the Fund to reflect new advancements in the realm of academic economics (conversion). Similarly, some degree of conversion in this case is also the result of certain subcultures within the institution assuming a more dominant position, thus using existing rules in new ways (Selznick 1949).

Other key authors in this field such as Clift (2018) have described this process as *bricolage*, which refers to actors crafting 'new institutional solutions by recombining elements in their repertoire' (Campbell 2004). This constructivist institutionalist (see Hay (2008, 2016), see also 'Discursive Institutionalism', Schmidt (2008, 2010)) approach to explaining institutional change is fundamentally similar in its analytical logic to the situated-agency-accommodating historical institutionalist approach I put forward here. However, the former has been criticised by some authors precisely for underestimating the importance of institutional structures in favour of an overly agent-centred approach that ignores the dialectical relationship between agents and their institutional environment (Bell 2011), which is an advantage of the situated-agency-accommodating historical institutionalist approach I propose. Regardless of whether we take a historical or constructivist institutionalist view of this process of gradual institutional change, it is clear that this change is anything but a radical one, despite the fact that the policies now advocated by the IMF seem on the surface radically different from previous ones. Therefore, we do not need to substantially rethink the way we conceive of institutions such as the IMF. Instead, the IMF still follows the same goal of achieving of economic recovery and sustainable long-term growth in creditor countries, not least because they are ultimately driven by the prospect of countries paying back loans. It is only the instruments to achieve this goal that have changed in their nature.

The European Commission is somewhat different from the IMF in this regard in that it is more political but that there is also more evidence for Commission technocrats to have stronger opinions and ideas regarding inequality and redistribution. Beyond the general notion that policy-makers are motivated by more than just selfish reasons and can in fact have stronger predilections to altruism than persons in other professions (Chang 2002; Etzioni 1988), an important contribution by Hooghe (2001) finds that EU bureaucrats are generally in favour of a more regulated form of capitalism characterised by more extensive social services and higher levels of redistribution. Rejecting the more market-oriented model of liberal market economies (Hooghe 2000), they seek to preserve and promote the European social model (Hooghe 2001; Ross 1995). Regressive cuts to the welfare state would seriously undermine this project.

Further to this, there is evidence that EU bureaucrats have recognised that the European social model has come under pressure and that they would prefer a stronger orientation towards policies that ensure more equity through redistribution (Ross 2011). In this regard one can conceive of the austerity measures in the EAPs as examples of a 'soft spots' that open up further policy options for agents to choose from (Mahoney and Thelen 2010). As long as fiscal consolidation as the primary goal is achieved, bureaucrats as institutional agents can exploit this soft spot by enforcing to some degree their own will and thus shape the exact design of the austerity measures accordingly. This is one way of making sense of the dilemma that Commission technocrats found themselves in: on the one hand seeking to implement a stronger social dimension – with the European Social Model, in fact, being enshrined in the Treaties, of which the Commission is the guardian – and on the other hand the strict austerity paradigm dictated primarily by Berlin. By adhering to the general austerity paradigm but ensuring that austerity measures were designed in a progressive fashion, Commission officials managed this balancing act.

Overall, the thesis has shown that there is a need to reconceptualise – or revive – existing theories on what guides policy makers, and in particular those in technocratic, non-majoritarian institutions, and how these institutions change, guided by individual actors and their ideas regarding what constitutes good policy.

B.4 Limitations and Further Research

This section serves to discuss some limitations of the research presented in the thesis as well as avenues for further research emerging from it. The first of these limitations concerns the measurement of income inequality. As discussed in Paper 1, there are stark shortcomings of the approach currently dominant in the discipline, which includes (1) ignoring relative and absolute poverty, and (2) the omission of public goods and services. This also underscores the fact that while this thesis has presented ample evidence as to the inequality-reducing nature of the analysed reforms, this does not provide a positive assessments of the reforms per se. Austerity in particular undoubtedly had vastly negative effects in Southern Europe, and particularly in Greece, especially because of the unwillingness of the creditor countries to lessen the austerity burden by expanding their own fiscal activity. The key question here is what the possible counterfactuals would have been and whether they would have produced better outcomes in the long run. The thesis remains agnostic towards this question.

A similar limitation of the analysis in this thesis is the omission of wealth inequality as an object of interest. Whilst undoubtedly important for the overall analysis of inequality, however, reliable data are difficult to obtain, although some improvements have been made in this regard recently, esepcially by the contributors to the *World Inequality Database* (World Inequality Database 2019; see also Alvaredo et al. 2018).

With regard to the issue of labour market dualisation, the analysis presented in this thesis remained at aggregate levels and did not further decompose workers other than according to their labour market status. However, we know from the literature that labour market dualisation has a distinct gender and age dimension (Emmenegger et al. 2012). Further research should therefore look at disentangling the effects of labour market reforms for these groups specifically in order to create a more nuanced portrait allowing for further policy conclusions.

Lastly, perhaps the most important avenue for further research relates to the long-term consequences of the reforms for the welfare state. A number of questions arise in this regard: Did the reforms transform domestic tax-benefit systems and labour markets sufficiently to restore competitiveness in the long-run? Did the reforms labelled as progressive in the case of Greece bring about a stable equilibrium of a more equal welfare regime? Have the reforms been sufficient for the EAP countries to be able to confront future crises without the need for assistance from their international partners? Are the Southern European welfare states ready for the challenges of the knowledge economy and sufficiently modernised as a result of the reform programmes? Conversely, whilst progressive in the short-run, as evidenced in this thesis, do the reforms (such as a strong focus on means-testing for benefit payments, which excludes larger parts of the population from accessing such benefits) undermine support for the welfare state in the long term, thus opening it up to further and extensive retrenchment in the future? These questions and more should be explored in further research on the comparative political economy of inequality, technocracy, and welfare states.

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