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Essays on the Two-Level Political Economy of Eurozone Crisis Conditionality

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Statement of Originality

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Essays on the Two-level Political Economy of Eurozone Crisis Conditionality

Abstract

This thesis investigates how the interaction between international and domestic politics shapes economic policy under conditionality in the Eurozone. Despite becoming politically toxic in certain countries following the Eurozone crisis, conditionality remains an important tool in EU economic governance. However, there are several questions regarding conditionality on which our understanding is still limited. First, how much space do borrower governments have to make choices under policy conditions? Second, what factors explain borrower governments' strategic behavior under conditionality? Third, under what conditions can conditionality lead to the implementation of policy changes by borrower governments with limited reform capacity? The three papers that form this dissertation address these questions by conducting in-depth comparative and single-case studies. Much of the analysis in the case studies relies on 35 original semi-structured in-depth interviews with senior Eurozone and IMF policymakers, including two former prime ministers, six former finance ministers, two former labor ministers, one national central bank governor, and a former European Commissioner. Paper 1 demonstrates that the interplay between conditionality and implementation constraints determines the space borrower governments have to choose a fiscal consolidation mix. Paper 2 contends that electoral concerns and bargaining power determine whether a government uses external and domestic constraints strategically during an adjustment program. Paper 3 shows strict conditionality can promote policy changes in countries with limited reform capacity, but at the cost of significantly reduced policy discretion for the borrower government. The

dissertation contributes mainly to debates about the viability of conditionality in EU governance but also has relevant implications for the scholarship on IMF programs.

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Essays on the Two-level Political Economy of Eurozone Crisis Conditionality

1 - *Introduction*

"Greeks have matured a lot. And we want to do our own reforms."[1] With these words pronounced at the height of the Covid-19 crisis, Greece's Prime Minister Kyriakos Mitsotakis expressed his opposition to the imposition of policy conditions in exchange for receiving funds from the European Union's (EU) new pandemic recovery facility. Given the recent experience of the Southern European country with conditionality, the Greek Premier's stance seems unsurprising. Having become the first Eurozone member state to ask for external financial assistance in 2010, Greece underwent three different Economic Adjustment Programs (EAPs) in eight years. During this period, the policy prescriptions negotiated between Athens and its official creditors – the EU and the International Monetary Fund (hereafter the IMF or "the Fund) – came to be perceived as an external imposition, a "forced adjustment" (Featherstone 2015; Kalyvas, Pagoulatos, and Tsoukas 2012). The unpopularity of the so-called bailouts also underpinned a time of significant political turmoil, with the country undergoing four elections during the bailout years.

Even if conditionality remains politically toxic for certain EU countries, policy conditions remain an important tool in EU governance. While the word "conditionality" has all but disappeared from the lexicon used by the EU institutions when dealing with the newly created pandemic support mechanisms, the logic of conditional assistance continues to underpin the provision of funds. For instance, to

[1] Financial Times (2020) *Mitsotakis vows Greece will not bow to EU conditions on Covid-19 aid*, 5 July: https://www.ft.com/content/d8fc01ae-5aac-4094-9b76-82ca0f90784c

receive money from the new Recovery and Resilience Facility (RRF), member states must draw up "national reform plans" (NRPs), which include policy changes they agree to implement. These documents are then assessed by the European Commission (hereafter the EC or "the Commission") and approved by the Council of the European Union (hereafter "the Council"). The disbursement of grant and loan tranches to member states is done upon the verification of the implementation of "milestones and targets."[2] In other words, funds still come with strings attached, even if the latter might be less tight than during the Eurozone crisis. Moreover, beyond the creation of a – so far untapped – temporary Pandemic Crisis Support (PCS) credit line, Eurozone crisis lending procedures have remained practically unchanged since their inception. The provision of financial assistance by the European Stability Mechanism (ESM) is still subject to the borrower government's signature of a macroeconomic adjustment program.

Despite the continued relevance of conditionality for EU governance, there is still much that we do not know about how EU governments behave under such an external constraint. The scholarship on the Eurozone crisis has explored myriad topics, such as the origins of the common currency's troubles (Copelovitch, Frieden, and Walter 2016; Frieden and Walter 2017; Hall 2014; Mourlon-Druol 2014) or the negotiation dynamics regarding the design of bailouts and the creation of new crisis management institutions (Bulmer 2014; Finke and Bailer 2019; Frieden and Walter 2019; Hennessy 2017; Lim, Moutselos, and McKenna 2019; Moschella 2016, 2017; Pitsoulis and Schwuchow 2017; Schimmelfennig 2015; Tsebelis 2016; Tsourapas and Zartaloudis 2022; Zahariadis 2016, 2017). Other studies have looked at the design of

[2] See https://ec.europa.eu/info/business-economy-euro/recovery-coronavirus/recovery-and-resilience-facility_en#documents

the EU's regime for supervising bailouts (Henning 2017; Hodson 2015), the disagreements between EU institutions and the IMF concerning their monitoring activities (Clift 2018; Lütz and Hilgers 2018), or the political consequences of bailouts and the crisis in general (Bosco and Verney 2016; Hopkin 2020; Ruiz-Rufino 2021; Schraff and Schimmelfennig 2019).

Regarding bailed-out countries specifically, some scholars have looked at the impact of different factors on conditionality negotiations (Genovese and Hermida-Rivera 2022; Lim, Moutselos, and McKenna 2019; Zahariadis 2016, 2017). Other studies have analyzed the policy reforms adopted under conditionality (Afonso, Zartaloudis, and Papadopoulos 2014; Branco and Cardoso 2020; Cardoso and Branco 2018; Featherstone 2015; Ladi 2014; MacCarthaigh and Hardiman 2020, among others). However, only a few studies have explored how borrower governments actually dealt with conditionality (Lütz, Hilgers, and Schneider 2019b; Moury et al. 2021) and, more specifically, how the interplay between the external constraint provided by conditionality and domestic political and institutional factors shaped economic policy outputs in borrower countries. In other words, how do Eurozone governments mediate between domestic and international pressures when crafting and implementing economic policies under conditionality?

The three papers that form this dissertation thesis try to tackle this broad question by contributing to three ongoing debates in the literature. The first debate revolves around the issue of how much space borrower governments enjoy to make policy choices under conditionality. The second topic concerns the factors that explain borrower governments' strategic behavior under conditionality, while the third debate considers the conditions under which conditionality can lead to the implementation of policy changes by borrower governments with limited reform capacity. The thesis aims

to contribute to discussions about the viability of conditionality in EU governance but also has relevant implications for the scholarship on IMF adjustment programs.

This introductory chapter is structured as follows. The first section provides the definition of conditionality to be used in the dissertation and reviews the importance of conditionality as a tool in EU governance. The second section discusses the relevance of Robert Putnam's (1988) two-level game theory as an appropriate framework to illustrate how governments behave under conditionality. The third section reviews the three academic debates the thesis aims to contribute to, while the fourth discusses the methodological choices made when producing my research. The fifth, sixth and seventh sections summarize the contents of the three papers, while the final section provides a roadmap for the subsequent chapters of the thesis.

1.1 Conditionality and the Eurozone Crisis

The Eurozone crisis arguably represented the most consequential shock to the EMU since its creation in 1992. There are many detailed accounts of how EU leaders struggled to deal with the challenges triggered by the currency union's financial troubles and the resulting policy responses (Bastasin 2012; Blustein 2016; Papaconstantinou 2016; Tooze 2019, to cite a few). Although a detailed description of the events that unfolded at the end of the 2000s and the beginning of the last decade is out of this dissertation's remit, one aspect of crisis management that merits commentary in the context of this thesis is the evolution of conditionality as a tool in EU economic governance. Wary of moral hazard, EU governments had decided at the origin of the EMU to declare that there would be no bailouts if one of its members faced financial difficulties (Frieden and Walter 2017, 375). Yet such a principle would eventually have to be abandoned when a potential default by Greece on its sovereign debt threatened the stability of the Eurozone. Given the lack of a lender of last resort

for the Eurozone, member states agreed to provide financial assistance to the country in exchange for implementing certain policies, a setting widely known as conditional assistance.

From a broad perspective, conditionality refers to "the granting of some good by a party (or a coordinated group of parties) to a second party that deems such a good valuable, linked to the latter party's compliance with some behavior valued by the former party" (Sacchi 2014, 79). In the realm of international relations, conditionality is conceptualized as an incentive that seeks to alter a state's behavior (Checkel 2000). The EU has used conditionality extensively in its accession processes, using it as a tool to promote domestic political and economic transformation in countries seeking to join the Union (Grabbe 2006; Hughes, Sasse, and Gordon 2004b, 2004a; Sasse 2008; Schimmelfennig and Sedelmeier 2004, 2020; Vachudova 2005), or specific areas of differentiated integration, such as the Economic and Monetary Union (Blavoukos and Pagoulatos 2008). In these cases, the possibility of being "part of the club" was the main incentive deployed to generate behavioral change in the aspiring states (Featherstone 2016).

The Global Financial Crisis (GFC) and the Eurozone crisis led to a shift in the use of conditionality by the EU, with the deployment of policy conditions akin to those traditionally used by organizations such as the IMF or the World Bank when supporting developing economies. The central characteristic of IMF-style conditions is the provision of financial assistance in exchange for the implementation of policy changes, with donors using their financial leverage in the pursuit of specific objectives (Killick 1997; Nelson 1996). Therefore, for the purposes of this dissertation, I define conditionality as "the placement of policy conditions on the disbursement of financial resources to national governments" (Babb and Carruthers 2008, 15).

The Economic Adjustment Programs (EAPs) agreed between the EU, the IMF, and Eurozone borrower governments did conform to the IMF's template used to assist developing economies (Greer 2014). EAPs consisted of two separate agreements between the national government and the EU on the one hand and the IMF on the other. While both organizations used different arrangements to provide emergency funding, programs followed the same pattern, with borrower governments agreeing to implement policy changes in exchange for funds.[3] As in the case of previous IMF programs, these commitments were codified into a Memorandum of Economic and Financial Policies (MEFP), while loan conditions negotiated with the EU were included in a Memorandum of Understanding on Specific Economy Policy Conditionality (MoU).[4] The disbursement of funds in tranches was authorized by the IMF's Executive Board (EB) and the Eurogroup, respectively, following the periodic verification ("quarterly reviews") by technical missions of the IMF, the European Commission (EC), and the European Central Bank (ECB) of whether the borrowing-government was in compliance with the prescribed policy conditions.[5]

The deployment of structural conditionality meant the EU effectively brought the "Washington Consensus" to Europe (Lütz and Kranke 2014). The term was coined by the economist John Williamson to describe the policies followed by Latin-American countries in the 1980s in response to the macroeconomic difficulties of the

[3] IMF assistance during the first Greek program (2010-2012) was extended under a Stand-By Arrangement (SBA), while the second program (2012-2015) was agreed under an Extended Fund Facility (EFF). An EFF was also agreed in the cases of Cyprus, Ireland and Portugal. Euro area crisis lending has gone through three different phases of institutional evolution. During the first Greek program, member states provided bilateral loans pooled by the EC into the so-called Greek Loan Facility. In 2010, the European Financial Stability Fund (EFSF) and the European Financial Stability Mechanism (EFSM) were created, followed by the creation of the permanent European Stability Mechanism (ESM) in 2012. EFSF funding was used in the cases of Ireland, Portugal (two countries that also received support from the EFSM) and Spain; ESM funding was used in the Cypriot program and the third Greek rescue package (2015-2018), in which the IMF did not participate because of its disagreements with the other creditors over the country's debt sustainability.

[4] An important difference between the two documents is that MoUs were more extensive and covered more policy issues (Independent Evaluation Office 2016, 25; Pisani-Ferry, Sapir, and Wolff 2013; Theodoropoulou 2014).

[5] A team from the ESM joined the so-called Troika from the first mission of the third Greek program onwards.

time, which were backed by the IMF, the World Bank, and the US Treasury (Irwin and Ward 2021). Among other measures, these policies included the reduction of budget deficits, the privatization of public assets, and the removal of barriers to market competition. The adoption of this template during the Eurozone crisis entailed a substantial leap in terms of the policy areas covered by EU conditionality. Jacoby and Hopkin (2019) argue that the conditionality deployed to help countries in the Eurozone periphery targeted "core state functions," such as fiscal or social policy, unlike enlargement conditionality or the macroeconomic policy prescriptions used in the assistance programs to Hungary, Romania, and Latvia during the early years of the GFC.[6]

Besides the wide range of policy areas covered by EAPs, the loan terms in Eurozone bailouts also substantially increased the intrusiveness of EMU conditionality, which until then prescribed the goals to be attained but not the means to reach them (Theodoropoulou 2014). The MoUs also specified the direction and timeframe for implementing reforms, which were subject to stringent monitoring by the lenders. The loan terms Eurozone borrower governments agreed to implement entailed a "hardening" of Europeanization mechanisms to promote economic convergence between EMU member states (Ladi and Graziano 2014). The MoUs aimed to "guide" the governance process in debtor countries (Spanou 2016), which is why analyzing the interaction of conditionality with domestic political and institutional dynamics is crucial to ascertain the impact of the former on the policies a

[6] Jacoby and Hopkin (2019) claim one of the main differences between EU enlargement conditionality and Eurozone bailout conditionality was that the former was ex-ante (requiring the fulfilment of conditions before obtaining the reward) and the latter ex-post (with assistance being provided before the implementation of conditionality). However, Eurozone EAPs also included ex-ante conditions in the form of prior actions that borrower governments had to implement before receiving a disbursement (see paper 3 of this dissertation).

borrower government implements. The next section explains why the concept of two-level games (Putnam 1988) is particularly well suited to explore such a dynamic.

1.2 Two-level games and conditionality

To study how Eurozone borrower governments manage international and domestic constraints under conditionality, the three papers in this dissertation rely on the two-level game theory of international negotiations developed by Robert Putnam (1998). The core argument of the approach is that national governments interact in parallel with other states or international organizations at the international level (Level I) and with the relevant constituencies at the domestic level (Level II). A deal is only possible when both levels' win-sets (the set of negotiation outcomes that domestic constituents can ratify) coincide.[7] As stated by Cohen (2008, 128), state behavior can be understood as "the product of policymakers' efforts to intermediate between the two levels."

Putnam's framework seems particularly well suited to analyze the behavior of executives in contexts of financial assistance by international and supranational institutions, as borrower governments must negotiate the contents of the loan terms while securing the consent of the relevant domestic actors for the implementation of the deal. In this context, the conceptualization of the "ratification" of an international agreement goes beyond parliamentary approval to encompass a wide range of actors, such as interest groups or bureaucratic agencies. In fact, in the article where he first developed the concept, Putnam cites IMF programs as a prominent example of the constraints a national government might face when trying to implement the terms of a loan. He suggests that "if labor unions in a debtor country withhold necessary cooperation from an austerity program that the government has negotiated with the

[7] The three papers in this dissertation jointly cover all the relevant concepts of the two-level game framework. For the sake of avoiding repetition, this section only sketches Putnam's overall argument broadly.

IMF, Level II ratification of the agreement may be said to have failed" (Putnam 1988, 436).

The concept of two-level games has been used profusely in the international relations literature, in areas ranging from trade negotiations to security agreements and regional integration, to name a few (da Conceição-Heldt 2013; Drezner 2003; P. B. Evans, Jacobson, and Putnam 1993).[8] Yet, despite the vast existing literature, the framework has only been scarcely used in the empirical study of conditionality in the context of IMF programs (Rickard and Caraway 2014, 703). Regarding the Eurozone, the concept has been applied to study EMU reform during the sovereign debt crisis (Crespy and Schmidt 2014), the negotiations between Greece and its creditors (Lim, Moutselos, and McKenna 2019; Zahariadis 2017), and the relationship between the EU and the IMF in their roles as supervisory organizations (Lütz and Hilgers 2018). However, only one study (to my knowledge) has used two-level games to explain the implementation of bailout conditionality, looking at the cases of Cyprus and Portugal (Lütz, Hilgers, and Schneider 2019b).

The empirical chapters of this dissertation each use the two-level game analytical lens to contribute to different debates in the conditionality literature, which are covered in the next section of this introduction. Besides giving the three papers conceptual consistency, the advantage of using the two-level game concept is that it allows me to capture the dynamic nature of conditionality negotiations. As expressed in the IMF literature, the initial letter of intent (the document signed by a borrower government at the beginning of a program) is only the initial point in a series of repeated discussions between the country's authorities and the institution (Kahler

[8] An excellent summary of the extensive two level-game literature can be found in da Conceição-Heldt and Mello (2018).

1993, 364). These repeated discussions take into account the economic and political developments that take place during the program, which feed into the design of conditionality (Mussa and Stavano 1999). Therefore, the two-level game approach is useful to unpack how domestic developments during the implementation of conditionality influenced the iterated discussions between Eurozone borrower governments and the international lenders and vice versa.

1.3 Contributions to debates

This dissertation aims to contribute primarily to the literature on Eurozone conditionality by focusing on how the interaction of external and domestic constraints shapes borrower countries' adoption of economic policies. It builds on recent studies exploring how borrower governments managed the implementation of the loan terms (Hardiman et al. 2019; Lütz, Hilgers, and Schneider 2019b; Moury et al. 2021). At the same time, the debates addressed by the papers that form this dissertation also connect with discussions held in other kinds of literature, such as the one on IMF programs. International Political Economy scholars have devoted significant attention to the variability in conditions given to different borrower countries (Barnett and Finnemore 2004; Breen 2013; Caraway, Rickard, and Anner 2012; Chwieroth 2015; Copelovitch 2010; Dreher and Jensen 2007; Dreher, Sturm, and Vreeland 2009; Dreher and Vaubel 2004; Kang 2007; Momani 2004, 2005; Pop-Eleches 2009; Rickard and Caraway 2014; Stone 2008, 2011) and the macroeconomic effects of structural adjustment programs (Biglaiser and DeRouen 2010; Boockmann and Dreher 2003; Chapman et al. 2017; Dreher and Rupprecht 2007; Stone 2002). However, the debate about how policy conditions influence the actual adoption of economic reforms has not received as much attention (Beazer and Woo 2016). There is still limited knowledge of how the interaction between a borrower government and the IMF affects the policies adopted

by borrower executives (Gunaydin 2018). More specifically, it is only recently that scholars have started to explore how domestic politics influence policy reforms under external conditions, for example, in areas such as labor markets (Gunaydin 2018; Lee and Woo 2021; Reinsberg et al. 2019). Therefore, the papers might also offer some useful insights for the study of structural adjustment programs in emerging economies.

1.3.1 Policy space under conditionality

The first paper delves into the fiscal consolidation strategies of Eurozone borrower governments to feed into the debate regarding the ability of executives to make choices under conditionality. This debate connects with a broader discussion about governments' room for maneuver in the globalization era. On the one hand, several studies claim that the challenges derived from the increasing economic interdependence between states have severely reduced the space of governments to implement policies aligned with their partisan preferences (Castles and Obinger 2007; Cusack 1999; Huber and Stephens 2001; Kittel and Obinger 2003; Swank 2001). Policymakers are increasingly under pressure to be "responsible" vis-à-vis external constraints such as international commitments and the need to maintain credibility with financial markets, which limits their ability to be "responsive" to the preferences of voters (Mair 2013). In a broadly similar vein, Rodrik (2011) claims in his famous trilemma of the world economy that the deepening of globalization can be combined with national sovereignty, but it requires the implementation of economic policies that reduce governments' margin of maneuver, hence undermining democracy.

In contrast, a second strand of the literature contends that governments still cater to their ideological constituencies when designing economic policies. For instance, two classic studies on welfare state reform claim that right-wing governments are more willing to cut social expenditures than left-wing cabinets (Allan and Scruggs

2004; Korpi and Palme 2003). However, other analyses suggest left-wing cabinets under broad coalitions are actually more likely to pursue more substantial cuts to welfare spending (Armingeon, Guthmann, and Weisstanner 2016) because they benefit from a 'Nixon goes to China' effect, allowing them to credibly claim they are best suited to preserve the welfare state (Green-Pedersen 2002; Kitschelt 2001; Ross 2000). Recent evidence has confirmed the importance of partisan effects on fiscal policy, albeit mediated by institutional and electoral considerations (Hübscher 2016; Jensen and Mortensen 2014). This continued relevance of domestic political factors seems to hold even during economic crises (Galasso 2014; Ha and Kang 2015; Pop-Eleches 2009; Starke, Kaasch, and van Hooren 2014).

The analysis of financial assistance programs agreed upon between borrower governments and International Financial Institutions (IFIs) has been subject to a similar discussion. A common criticism of these programs is that they force borrowing countries to apply a "one-size-fits-all" set of policies regardless of their domestic realities (Easterly 2001; Stiglitz 2002; Willett 2001). However, recent studies have found that domestic political factors such as partisanship continue to determine how countries react to economic crises (Pop-Eleches 2009). Furthermore, domestic politics in borrower countries seem to play a role in shaping the strictness of IMF conditionality which, in turn, determines how much margin of maneuver executives enjoy (Caraway, Rickard, and Anner 2012; Rickard and Caraway 2014).

Regarding Eurozone conditionality specifically, several authors claim that MoUs significantly limited borrower governments' discretion to make democratic choices, forcing them to adopt the same template of neoliberal policies (Armingeon and Baccaro 2012; Matthijs 2017; Scharpf 2013). A different set of scholars has countered this argument by suggesting Eurozone borrower governments had some

room to make non-trivial policy decisions under conditionality and that their partisan preferences made a difference in their negotiations with the lenders. For instance, Genovese and Hermida-Rivera (2022) contend that the design of conditionality varied depending on the ideology of the borrower governments. Meanwhile, Hick (2018) shows that the political preferences of the Irish executive influenced its decision to prioritize pensioners over children in welfare reform, which was enabled by the focus of the Troika on deficit reduction targets rather than specific policies. Moreover, Moury et al. (2021) argue that the bailout terms were not a "diktat" and that borrower governments had some leverage to shape MoU conditionality because the lenders value "ownership" of the program and the insider knowledge executives have regarding the policy areas targeted by conditionality.[9]

I argue that one of the blind spots of the extant literature is that it neglects how the prioritization of certain policy goals over others might influence how much room borrower governments enjoy. The first paper of this dissertation addresses this limitation by looking at how conditionality and implementation constraints shaped fiscal consolidation strategies in three Eurozone borrower countries (Greece, Ireland, and Portugal). It demonstrates that fiscal conditionality initially erases ideological differences regarding adjustments, as consolidation measures mainly reflect the preferences of the lenders for cutting expenditures, which are aligned with those of center-right governments. However, even center-right executives see their margin of maneuver severely reduced when facing implementation constraints, as they are forced to raise taxes to cover fiscal slippages with the aim of meeting annual deficit targets.

[9] Ownership has been defined as "a willing assumption of responsibility for an agreed program of policies, by officials in a borrowing country who have the responsibility to formulate and carry out those policies, based on an understanding that the program is achievable and is in the country's own (Boughton, 2003)." Ownership is thought to increase the chances of a program's success (Khan and Sharma 2001). For critiques of the concept see Buiter (2007) and Spanou (2016).

In other words, even if lenders prioritize the fulfillment of goals over the choice of policy mix, the pursuit of those targets can still severely restrain the policy space of borrower governments.

1.3.2 Strategic behavior of governments under conditionality

The second debate revolves around how borrower governments deal simultaneously with international and domestic constraints in the context of financial assistance programs, with the literature offering two opposite predictions. On the one hand, several scholars have suggested that some governments apply for financial assistance from the IMF and/or use program conditionality to gain leverage to implement economic reforms that otherwise they would not be able to implement because of domestic opposition (Drazen 2002; Putnam 1988; Rogers 2009; Vreeland 2003a). In other words, conditionality can enhance the power of national executives, much like EMU accession empowered the technocratic elites of EU members states such as Belgium, Italy, or Greece to push for certain economic policies at home (Featherstone 2003; Featherstone and Dyson 1996; Pochet 1999).

This argument has been widely applied to Eurozone bailouts, with scholars claiming that borrower governments sometimes took advantage of the MoUs to implement policy changes they had traditionally favored. Moury and Standring (2017) point to the Portuguese government as a clear example of an executive that uses conditionality strategically to pass reforms at home. Asensio and Popic (2019) make this argument regarding the Portuguese executive’s health reforms during the bailout period. In a similar vein, MacCarthaigh and Hardiman (2020) suggest the Irish government “exploited” conditionality to push for specific public administration reforms. More broadly, Lütz, Hilgers, and Schneider (2019b) claim both Portugal and Cyprus transferred the external pressure created by the bailout to domestic veto players

to overcome their opposition. Meanwhile, Moury et al. (2021) contend that the loan terms specifically empowered reformist ministers within the national executives, reinforcing them vis-à-vis domestic actors.

On the other hand, certain studies contend that borrower governments sometimes use domestic constraints to extract concessions in conditionality negotiations. In line with the argument first made by Schelling (1960) and developed by Putnam (1988), governments can point to the risk of domestic actors blocking ratification of an agreement to gain a bargaining advantage in international negotiations. In the case of IMF programs, Caraway, Rickard, and Anner (2012) claim borrower governments facing strong labor movements can obtain more lenient labor conditionality, as the IMF cares about appearing sensitive vis-à-vis domestic political realities and the overall success of its adjustment programs. A similar argument is made by Rickard and Caraway (2014), who contend that executives facing imminent elections are able to negotiate less stringent labor conditionality with the Fund.

In the case of Eurozone bailouts, some studies suggest borrower governments tried to use domestic opposition to reform to extract better deals in their negotiations with the EU and the IMF. Still, such a strategy was rather ineffective given the high cost of no agreement for Eurozone countries needing financial assistance. For instance, Zahariadis (2017) shows that stronger domestic constraints led Greece to harden its bargaining vis-à-vis the international lenders. Similarly, Lim, Moutselos, and McKenna (2019) contend that Greece's ability to obtain some concessions in negotiation was not derived from domestic constraints but from its structural economic weakness, which made the possibility of unilateral default more material in the eyes of the creditors. Moury et al. (2021, 150) do not focus on domestic constraints, but claim borrower governments still had some bargaining leverage in conditionality

negotiations, which derived from several factors, such as the urgency of striking a deal, the costs of no deal for the lenders, borrower governments' credibility vis-à-vis the international lenders, their insider policy knowledge, and the saliency of the relevant policy issues for the lenders.

The second paper contributes to this debate by reconciling the two competing predictions provided by the literature, highlighting that both strategic behaviors are compatible during an EAP. Looking at the case of Portugal, I show that reform-minded governments using conditionality to pass economic reforms at home might also be willing to use domestic constraints to push back against demands for reforms that might hurt them politically. I also contend that whether a government is able to use international and domestic constraints strategically is strongly dependent on the cost of no agreement for itself and the domestic actors that are relevant for the implementation of the deal. The paper serves as a reminder that, despite the fundamentally technocratic nature of conditionality, its implementation remains essentially a political process. Therefore, it is only logical for political incentives to strongly influence borrower governments' strategic behavior even when their preferences regarding economic policy are strongly in line with those of EU and IMF bureaucrats.

1.3.3 Implementation of reforms under conditionality

The third and final debate this dissertation contributes to is the discussion on whether conditionality leads to the implementation of economic reforms, particularly in those borrower countries where there is traditionally strong opposition to policy changes of the type promoted by EAPs. Starting with the IMF literature, scholars have provided conflicting evidence on the matter. On the one hand, some studies argue that participating in an IMF program actually reduces the chances of economic reform

(Dreher and Rupprecht 2007) and that conditionality has no impact on the level of "economic freedom" (Boockmann and Dreher 2003). However, other analyses argue that IMF programs triggered inflation-reducing reforms in post-soviet countries (Stone 2002) and policy changes leading to trade and capital account liberalization in Latin America (Biglaiser and DeRouen 2010). Recent studies also highlight the importance of domestic political factors for the implementation of reforms under conditionality. For instance, Doyle (2012) suggests left-wing governments are less willing to privatize public assets under IMF conditionality, while Gunaydin (2018) shows leftist governments are reluctant to push for labor reforms during election years and when they face a high degree of mobilization by trade unions. Meanwhile, Beazer and Woo (2016) claim strict conditionality leads to more reforms under left-wing governments than under right-wing executives, given extensive IMF conditions reduce the room for conservative governments to build the necessary coalitions in favor of policy changes.

The scholarship on Eurozone bailouts has been much less dichotomous on the matter of whether conditionality led to economic reforms in borrower countries. Moury et al. (2021, 155) show that the five member states subject to bailout conditionality implemented most of the reforms included in their respective MoUs, confirming preliminary data from other studies (Terzi 2015). Still, such an outcome seems counterintuitive in the case of countries such as Greece, whose limited reform capacity prior to the crisis had been well documented (Featherstone 2016; Featherstone and Papadimitriou 2008; Mitsopoulos and Pelagidis 2011; Sotiropoulous 2012).

The implementation of conditionality was rather problematic during the first two Greek programs (Featherstone 2015, 2016), with ministers and civil servants trying to block the reforms dictated by the MoUs in certain instances (Exadaktylos and Zahariadis 2014; Zahariadis 2013). However, the third bailout saw a substantial

acceleration of reforms mandated by conditionality under the government of anti-austerity radical left party SYRIZA (an abbreviation for Coalition of the Radical Left-Progressive Alliance). From a negotiation standpoint, there is a strong consensus that Greece was in a systematically disadvantageous position vis-à-vis the creditors (Lim, Moutselos, and McKenna 2019; Tsebelis 2016; Zahariadis 2017), which by itself does not account for the variation in program implementation across time. Hennesy (2017) explains different levels of conditionality enforcement by focusing on the role of credible signals in negotiations. According to her argument, the enforcement of conditionality increases when creditors can convincingly signal that they are willing to withdraw financial assistance. The threat of creditors potentially opting for an option outside of cooperation suffices for a borrower government to implement the reforms mandated by conditionality, provided that the politicians heading the executive have sufficient control over bureaucrats to enforce the implementation of reforms.

One key limitation of explaining reforms under conditionality by looking at discrete negotiation episodes is that such an approach overlooks potential commitment problems at the implementation stage. For instance, a government might accept the terms of an international agreement in initial negotiations under the threat of non-cooperation, only to then thwart the implementation of some parts of the deal by using strategies such as foot-dragging or exploiting the ambiguity of the agreement to limit its potential costs (Abbott et al. 2000; Börzel 2002; Chayes and Chayes 1995). Defection from an international agreement can also be involuntary, where a chief negotiator overestimates his ability to get an international agreement ratified at home, with domestic actors blocking its implementation (Moravcsik 1993; Putnam 1988).

The third paper of this dissertation posits that international bureaucrats solve commitment problems through program design. In this regard, international lenders do

not initially have full information about the ability of an executive to translate into policy the conditions agreed at the outset of a program. However, once they acquire enough information about the obstacles to reform in the borrower country, they can "harden" conditionality by linking its implementation more tightly with funding and making policy conditions more specific. Such an approach leads to reforms when the borrower government considers the threat of withdrawal of financial assistance to be credible enough in the event of non-compliance. In other words, credible threats become effective at promoting reforms when they are "embedded" in program conditions. Moreover, credible signaling leads to a higher reform intensity under conditionality when politicians' discretion over the relevant bureaucratic units is reduced, contrary to existing explanations.

To sum up, this dissertation contributes to the academic literature in three ways. First, it calls for paying more attention to program design to better understand how much policy space borrower governments enjoy under conditionality. Second, it reconciles two competing theoretical predictions by specifying the conditions under which borrower governments use external and domestic constraints strategically. Third, it argues that coercive threats by international bureaucrats translate into reform implementation when politicians' discretion over the enforcement of the policy prescriptions is low, in contrast to extant accounts. I now turn to an overview of the methodology and the data sources used in the three papers of the dissertation.

1.4 Methodology and data

The thesis tests the hypotheses advanced in each paper through case studies covering three Eurozone borrower countries. The first paper conducts a comparative study of Greece, Ireland, and Portugal, while the second and third papers rely on single case studies of Portugal and Greece, respectively. The use of case studies is motivated by

the research questions guiding the papers, and each of them provides an explanation of the rationale behind the selection of the specific cases.

The research draws from multiple qualitative sources, with the main empirical contribution of the thesis being 40 semi-structured in-depth interviews, 35 of which were with senior policy elites. Given that international negotiations such as those between borrower governments and international lenders are hard to observe directly (Odell and Tingley 2013, 170), interviews are one of the only ways of gauging the causal relationships the paper is trying to identify (Mosley 2013, 5).

Constructing the universe of relevant individuals to be interviewed was challenging as, in certain cases, there was a significant amount of turnover in the institutions involved in program monitoring. Individuals were divided into seven different categories according to their occupations. The goal of such a division was to collect data from individuals with different levels of responsibility in negotiating program conditionality and implementing it. An extensive description of the strategy followed to construct the sample can be found in Appendix 1 of this dissertation.

A sample of 55 potential interviewees was contacted, and 40 individuals accepted to be interviewed. Out of this sample, 35 interviews were conducted with senior policymakers from the governments of Ireland, Greece, and Portugal, the European Commission, and the IMF, including two former prime ministers, six former finance ministers, one national central bank governor, and a former European Commissioner. All of them had decision-making responsibilities regarding different aspects of Eurozone bailouts.[10] For triangulation purposes, the list also includes five

[10] Since the ECB's staff was less involved in the discussion of structural conditionality and its approach to fiscal policy broadly coincided with that of the European Commission (Lütz, Hilgers, and Schneider 2019b), I decided to prioritize interviews with individuals of the latter institution.

interviews with journalists who covered the events closely and academic experts. Several interviewees requested not to be identified, while others agreed for their names to be mentioned but not to be quoted directly. As a result, the interviewees are referred to by codes in the papers.

The data from the interviews is integrated with the analysis of primary textual sources, including the quarterly reviews of the EAPs by the IMF and EU institutions, the ex-post evaluations of the programs conducted by a range of institutions, such as the European Commission, the IMF, the European Court of Auditors, the European Parliament, and the European Stability Mechanism. In addition to high-profile decision-makers' public statements, the papers also examine the numerous first-hand accounts of the bailouts' management by some of the key protagonists of the Eurozone crisis (Avilez 2014; Cavaco Silva 2018; Dijsselbloem 2018; Gilmore 2015; Papaconstantinou 2016; Santos Pereira 2014).

Finally, the dissertation also uses a wealth of secondary sources, including journalistic accounts (Bastasin 2012; Dendrinou and Varvitsioti 2019; Dinis and Coelho 2012; Leahy 2013; Reis Pires 2015) exploring different dimensions of Eurozone bailouts, from the negotiations of conditions to the implementation of loan terms by the respective borrowing countries. The analysis is complemented with insights from research reports by think tanks (Pisani-Ferry, Sapir, and Wolff 2013) and the existing academic literature on the Eurozone crisis. The goal of combining these sources is to verify as much as possible the reliability of the data obtained through the interviews through triangulation.

The next three sections summarize the contents of each of the three papers that form the core of this dissertation.

1.5 Paper 1: Maastricht on Steroids: The Political Economy of Fiscal Consolidations in Eurozone Bailouts

The first paper tackles the issue of how much space Eurozone borrower governments had to make policy choices under conditionality. It responds to recent work arguing that executives had some room for maneuver to influence the design of the policies they implemented during their bailouts. For instance, Hick (2018) argues that the Troika's focus on deficit targets left the Irish government enough space to make important choices regarding social security reform. Similarly, Moury et al. (2021) contend that governments had some space to design reforms given that international lenders cared about "ownership" of the program by the national authorities. I claim instead that the lenders' focus on targets actually restricted borrower governments' room for maneuver when facing implementation constraints, despite the Troika's concerns about ownership.

The paper focuses on the composition of fiscal consolidation, that is, the balance between spending cuts and revenue-raising measures that governments choose to implement during fiscal adjustments. The paper is, to my knowledge, the first analysis of the politics surrounding the choice of adjustment strategies under conditionality during the Eurozone crisis. There is a rich literature on the composition of fiscal consolidations in OECD countries, which points to factors such as partisanship and institutional fragmentation as the main factors behind the choice of consolidation strategy by executives (Castles 2007; Mulas-Granados 2006; Perroti 1996; Perroti and Kontopoulos 1999; Tavares 2004). Using these studies as a point of departure and relying on Putnam's two-level game framework, I examine the cases of Greece, Ireland, and Portugal during the Eurozone crisis. I show that adjustment programs initially reflect the preferences of the lenders and center-right governments

for expenditure-based consolidation. However, conditionality was eventually restructured when executives faced implementation obstacles in the form of fiscal slippages, which forced governments to hike taxes to meet the agreed deficit targets.

The main insight from the paper is that the inflexibility of the lenders regarding fiscal targets "hardened" the conditionality constraint by embedding a strict application of the EU's Excessive Deficit Procedure (EDF) in the design of programs. Such an approach intensified an important dynamic Blavoukos and Pagoulatos (2008) had identified in Southern Europe in the years leading to the EMU accession, namely, the adoption of measures to raise revenue quickly to reach the established targets under the new fiscal rules. This outcome is why the paper claims fiscal conditionality in the Eurozone bailouts was equal to putting the Maastricht criteria "on steroids."

The paper makes two contributions to the literature. First, it suggests that conditionality initially deletes ideological differences between governments regarding the composition of fiscal adjustments. Second, it shows that the interaction between program design and implementation constraints can reduce the room for maneuver that governments have to design fiscal adjustments in line with their preferences. In sum, the paper calls for paying greater attention to the interplay between program design and implementation constraints when trying to understand the ability of borrower governments to influence the design of policies under conditionality.

1.6 Paper 2: Bonds, Ballots, and Tied Hands: The Politics of Labor Reform under Conditionality in Portugal

The second paper tries to reconcile two different predictions traditionally made by the literature regarding how governments manipulate international and domestic constraints under conditionality. On the one hand, several studies claim conditionality

strengthens national executives by allowing them to impose reforms normally resisted by domestic actors (Drazen 2002; Putnam 1988; Rogers 2009; Vreeland 2003). This line of argument has been applied to the Eurozone, with several authors claiming that the bailouts allowed executives to implement reforms that they favored, sometimes by inserting them into program conditionality during talks with the Troika (Freire and Moury 2013; Lütz, Hilgers, and Schneider 2019b; MacCarthaigh and Hardiman 2020; Moury et al. 2021; Moury and Standring 2017). On the other hand, some studies argue that executives sometimes use domestic political constraints to obtain more lenient conditions from the IMF (Caraway, Rickard, and Anner 2012; Rickard and Caraway 2014), also known as a "tied hands" strategy. In the case of the Eurozone bailouts, governments sometimes tried to use domestic obstacles to reform in an effort to extract some concessions from the Troika, even if the efforts were not particularly effective (Lim, Moutselos, and McKenna 2019; Zahariadis 2017).

The paper is the first to argue (to my knowledge) that both strategies are compatible under bailout conditionality. I rely on Putnam's two-level game framework to claim that the strategic behavior of executives is determined by the changing costs of no agreement and the electoral risks the government face during the duration of the bailout. To verify the proposed argument, I analyze the implementation of labor market reforms under conditionality in Portugal between 2011 and 2014. The paper shows that governments favoring reforms of the kind promoted by EAPs use conditionality to overcome domestic resistance to reform when the cost of no agreement with the Troika is high, and they face a low risk of being replaced in an election. At the same time, the same government will use domestic constraints to push back against international lenders' demands for further reforms when it faces rising electoral risks and the cost of no agreement rises.

I contribute to the literature by showing that electoral considerations are key to ascertaining how governments behave strategically under conditionality. Given the alignment of preferences between international lenders and reform-minded executives, both actors have an incentive to collude so that the borrower government can implement the agreed reforms. However, international bureaucrats and politicians ultimately face different sets of incentives, as the latter want to hold power in addition to making policy (Müller and Strøm 1999). Therefore, the collusion between the lenders and a borrower government ends where the latter's electoral worries begin. Furthermore, the paper also highlights the importance of the cost of no agreement as a key variable in understanding the willingness of a borrower government to use conditionality and domestic constraints strategically.

1.7 Paper 3: Selling the Family Silver under Pressure: Privatization in Greece during the Eurozone Crisis

The third paper examines the issue of whether conditionality leads to economic reforms in cases of governments where domestic actors are strongly opposed to the type of policy changes promoted by EAPs. It looks at the case of privatization policy in Greece, a country that had shown a limited capacity to implement reforms in the years leading up to the Eurozone crisis (Featherstone 2016; Featherstone and Papadimitriou 2008; Mitsopoulos and Pelagidis 2011; Sotiropoulous 2012). Despite this background, the government implemented a large majority of the reforms included in its bailout conditionality, with an acceleration of reforms taking place under an executive led by the radical-left party SYRIZA, which had strongly opposed the implementation of the loan terms while in opposition.

The literature has so far explained the implementation of reforms by Greece as a function of the credibility of creditors' threat to withdraw their financial assistance

in conditionality negotiations (Hennessy, 2017). However, the third paper argues that this explanation does not account for potential defection problems, as borrower governments might try to limit the cost of reforms mandated by conditionality during their implementation. Instead, I contend that international bureaucrats try to solve commitment problems by making conditionality more determinate and tightening the link between implementation and funding. This approach is effective only when the borrower government considers the threat of non-payment of financial assistance to be credible.

The paper demonstrates that the Troika made conditionality targeting privatization policy much more specific with each Greek bailout as the lenders learned about the existing implementation constraints on divestiture, a strategy that reached its apex in the third program. The lenders also multiplied the number of prior actions targeting privatizations. During the third EAP, the government had no other option but to push for the necessary measures to sell public assets to continue receiving the funds to pay for public expenditure. The fact that Greece had been on the brink of exiting the Eurozone during the initial negotiations of the third bailout also increased the credibility of a potential withdrawal of financial assistance in the event of non-implementation of the demanded privatization actions by the government.

In addition to underscoring the importance of program design to understand the implementation of reforms under conditionality, the paper shows that credible signaling by creditors led to higher reform intensity under conditionality in Greece when the government's discretion to influence the decisions and operations of the relevant bureaucratic units was significantly reduced, contrary to the what the literature suggests. Such a development in the use of policy conditions by the EU has important normative implications, as it highlights the inherent clash between the imperatives

created by conditionality and the ability of democratically elected national politicians to make policy choices (Sánchez-Cuenca 2017; Scicluna and Auer 2019; Spanou 2016).

1.8 Structure of the dissertation

The rest of the dissertation is structured as follows. Chapters 2, 3, and 4 each cover one of the papers that form the core of this dissertation and are conceived as independent pieces of research. The last chapter discusses the papers' theoretical contributions, the dissertation's limitations, and potential avenues for further research. The final chapter also enumerates a number of policy implications from the dissertation.

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2 - *Maastricht on Steroids: The Political Economy of Fiscal Consolidations in Eurozone Bailouts*

Abstract

How much space do borrower governments have to make policy choices under conditionality? The literature on Eurozone bailouts suggests that bailed-out countries had some room to shape their economic policies within the heavily constrained context provided by conditionality. However, in some cases, executives could not deliver fiscal consolidations in line with their preferred policy mix, delivering adjustments that were substantially more revenue-based than initially envisaged. Drawing from Putnam's (1998) two-level game framework, I argue that programs initially reflect the preferences of the lenders on the composition of fiscal consolidation, but conditionality is restructured by domestic implementation constraints in borrower countries. Looking at the cases of Greece, Ireland, and Portugal during the Eurozone crisis, I show that the prioritization of annual deficit targets by international lenders forces Eurozone borrower governments to raise taxes when facing fiscal slippages due to factors outside their control. The contribution of this paper, the first to analyze the choice of fiscal adjustment mix under Eurozone bailouts, is two-fold. First, it shows that conditionality erases ideological differences between governments over the composition of fiscal consolidation. Second, it suggests program design and domestic constraints crucially shape the policy space of borrower governments, which becomes severely reduced when covering slippages to reach deficit targets turns into fiscal policy's primary goal.

2.1 Introduction

The use of conditionality to promote domestic policy change at the beginning of the last decade represented a paradigm change in EU economic governance. While EU institutions had used policy prescriptions to achieve specific goals in several areas before the crisis, Eurozone bailouts covered a wider range of economic policy areas with a much higher degree of intrusiveness (Featherstone 2015; Jacoby and Hopkin 2019; de la Porte and Heins 2016; Theodoropoulou 2014). Some authors have claimed that this approach forced borrower governments to adopt the same set of policies defined by EU and IMF technocrats (Armingeon and Baccaro 2012; Matthijs 2017; Scharpf 2013). However, recent studies suggest that bailed-out executives did have some room to make decisions within the limits set by their respective Economic Adjustment Programs (EAPs), including in relation to how to consolidate their budgets (Genovese and Hermida-Rivera 2022; Hardiman and MacCarthaigh 2013; Hick 2018; Moury et al. 2021).

This paper advances an alternative argument. Drawing from Putnam's (1998) two-level game framework, I posit that programs initially reflect the preferences of the lenders on the composition of fiscal consolidation, but conditionality is restructured by domestic implementation constraints in borrower countries. Looking at the cases of Greece, Ireland, and Portugal during the Eurozone crisis, I show that the prioritization of annual deficit targets by the international lenders forced governments to raise taxes when faced with fiscal slippages due to factors outside their control. The core argument is that creditors' inflexibility on fiscal matters, which was enshrined in program conditionality, significantly "hardened" the constraint provided by the Excessive Deficit Procedure (EDF). This approach magnified dynamics seen in the run-up to EMU accession in certain member states, namely the adoption of revenue-raising

strategies to meet nominal deficit goals (Blavoukos and Pagoulatos 2008). In other words, I argue that fiscal conditionality in Eurozone bailouts put the Maastricht criteria "on steroids."

This paper's contribution is two-fold. First, it shows that stringent conditionality erases ideological differences between governments over the composition of fiscal consolidation. Second, it suggests design and domestic constraints crucially shape the policy space of borrower governments, which becomes severely reduced when covering fiscal slippages to reach deficit targets turns into fiscal policy's primary goal. Moreover, the findings inform the discussion about the design of fiscal rules within EMU governance. Debt and deficit rules in recent years have been seen to increasingly prioritize "responsibility" towards Eurozone counterparts over "responsiveness" towards electorates (Doray-Demers and Foucault 2017). The article suggests that bailout conditionality, in fact, even undermined the ability of governments to deploy policies that the economics literature deems "responsible" by forcing governments to pursue adjustments heavily based on raising revenue, generally seen as less sustainable in the long term (Buti and Sapir 1998; Perroti, Strauch, and von Hagen 1998). To my knowledge, this paper is the first study to analyze the politics surrounding the choice of fiscal consolidation strategies under conditionality during the Eurozone crisis.

To substantiate the proposed explanation, the paper performs a comparative analysis of the implementation of fiscal conditionality in three Eurozone countries under EAPs during (roughly) the same period: Greece, Ireland, and Portugal. Of these, only Ireland delivered an expenditure-based consolidation at the end of its program despite all three countries agreeing to an adjustment centered on spending cuts. The analysis in the case studies draws on semi-structured interviews with senior

policymakers from the national governments and the international lenders.[11] This data is complemented by the analysis of policy documents (e.g., EU and IMF quarterly program reviews and program evaluations by different institutions), public statements by key decision-makers, first-hand accounts from high-level decision-makers, and insights from the secondary literature.

The paper proceeds as follows. The next section explains the puzzle provided by the composition of fiscal consolidation under Eurozone bailouts. The second section explores potential answers from the literature and proposes an alternative explanation. The third section analyzes the cases of Greece, Ireland, and Portugal under external fiscal conditionality. The final part discusses the evidence laid out in the case studies and summarizes the article's main conclusions.

2.2 Fiscal consolidation in Eurozone bailouts

A primary goal of the EAPs was for the executives of the bailed-out countries to cut their budget deficits. The Memoranda of Economic and Financial Policies (MEFP) and the Memoranda of Understanding on Specific Economy Policy Conditionality (MoU) required borrowing governments to adopt fiscal consolidation measures to reach annual deficit goals set under the Excessive Deficit Procedure (EDP). The adoption of measures to fulfill these targets was to be evaluated quarterly by technical missions of the IMF, the European Commission (EC), and the European Central Bank (a.k.a. the "Troika" of international monitors). A positive assessment by the Troika was a prerequisite for the IMF's Executive Board (EB) and the Eurogroup to authorize the disbursement of their respective loan tranches.

[11] Some interviewees requested full anonymity, while others agreed for their names to be mentioned but asked not to be quoted directly. As a result, all contributions have been kept anonymous and are referred to by codes (see Appendix 1 for a list of the interviewed individuals).

Broadly speaking, governments can implement a fiscal adjustment by either decreasing spending (expenditure-based consolidations) or increasing revenues (revenue-based consolidations). EU policymakers have generally seen expenditure-based adjustments as having "better track records of success than ones based on tax increases" (European Commission 2010b, 6).[12] This view connects with an intellectual tradition that sees expenditure-based consolidations as the best way to signal a government's commitment to fiscal consolidation and generate positive investment expectations, thereby leading to higher aggregate growth rates (Alesina and Ardagna 1998; Giavazzi and Pagano 1990; Perroti 1996). The IMF's preference for expenditure-based consolidations has also been well documented (International Monetary Fund 2010c, 2010a; McDermott and Wescott 1996).

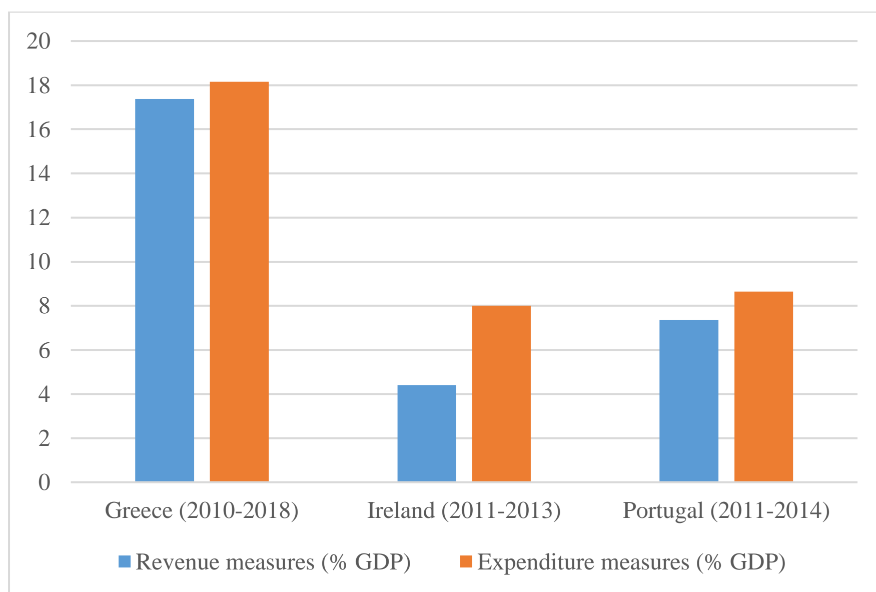
The initial documents for each EAP confirm such a preference for expenditure-based adjustments, with about two-thirds of consolidation measures expected to come from spending cuts. For instance, the adjustment planned in the Greek case foresaw cuts equivalent to seven percent of GDP and revenue increases equal to four percent of GDP. The Commission's rationale for this policy mix was that experience showed that "expenditure-based consolidation has more chance of success, in particular for large consolidation efforts" (European Commission 2010c, 19). In Ireland, out of the planned EUR 15bn adjustment, EUR 7bn were supposed to come from cuts to current expenditure, EUR 3bn from reductions in capital expenditure, and EUR 5bn from revenue increases (European Commission 2011e, 26). As for Portugal, the agreed consolidation package foresaw a similar composition, with two-thirds of

[12] According to several authors, this intellectual lineage has been prevalent in the epistemic communities underpinning EU economic governance (Blyth 2013; Dellepiane-Avellaneda 2015; Helgadóttir 2016).

the adjustment expected to come from spending cuts (European Commission 2011f, 18).

To establish the composition of consolidation programs, I draw from data from the relevant government institution in each country about the estimated impact of the fiscal consolidation measures adopted during the bailout period on expenditures and revenues.[13] Besides the adjustment size – significantly larger in Greece – the graph below shows that Ireland was the only country able to deliver an adjustment focused primarily on cuts during its EAP. Portugal and Greece both ended up implementing adjustments balanced between revenue increases and cuts.

Figure 2.1: Fiscal consolidation outcomes in three Eurozone countries



Sources: Lalountas (2014) and Pagoulatos (2018) for Greece; Passos Coelho (2019) for Portugal; Scott and Bedogni (2017) for Ireland

In addition to the data provided by the national governments, the evaluations of Greece's, Ireland's, and Portugal's EAPs conducted by several EU institutions and the IMF also help to confirm the composition of the adjustments in each country. In

[13] The mentioned government institutions are the finance ministries of Greece and Portugal, and the Department of Public Expenditure and Reform in Ireland.

evaluating the first Greek program, the Fund considered the implemented adjustment mix as "revenue heavy, given that the fiscal crisis was expenditure driven" (International Monetary Fund 2013a, 23). While consolidation in the second program relied more on spending cuts, the composition between spending cuts and revenue measures remained broadly balanced during the third (European Stability Mechanism 2020, 53).

Looking at the Portuguese program, the Commission's evaluation describes how "the consolidation effort turned out to be more revenue-based than initially projected" (European Commission 2016c, 65). The IMF's assessment concurs, stating that the composition of consolidation "was less supportive of growth than planned, with efforts shifting to the revenue side as spending cuts failed" (International Monetary Fund 2015, 17). In contrast, in the case of the Irish program, the IMF's ex-post evaluation confirmed that the country delivered an adjustment where two-thirds of the implemented measures were expenditure-based (International Monetary Fund 2015, 30). The next section explores potential answers to these discrepancies in the relevant literature.

2.3 Fiscal adjustments under external conditionality

The composition of a fiscal adjustment is defined as the "group of measures needed to balance the cyclically adjusted primary budget" (Mulas-Granados 2006, 47). When explaining the differences in the composition of fiscal consolidations in OECD countries, the political economy literature has tended to stress primarily the importance of domestic factors. A group of scholars has highlighted the role of the partisan preferences of governments, with left-wing executives opting to follow revenue-based strategies or to limit spending cuts as much as possible and right-wing governments preferring to cut expenditure in areas such as capital formation, social transfers, and

public wages in order to avoid raising taxes (Castles 2007; Mulas-Granados 2006; Tavares 2004). In contrast, a second set of studies has stressed the importance of institutional fragmentation, with non-majoritarian and more fragmented governments traditionally choosing revenue-based adjustments (Fabrizio and Mody 2006; Perroti and Kontopoulos 1999). According to this literature, reducing expenditure is more difficult for governments where many actors with influence on fiscal policy try to preserve their share of expenditure (Poterba 1994; Roubini and Sachs 1989). Only institutional settings that grant the finance minister veto power and/or rules-based fiscal contracts can help overcome such bias (Hallerberg and Wolff 2008; Mulas-Granados 2006). However, fiscal consolidation outcomes in Eurozone bailouts do not seem to fit explanations based on domestic partisan or institutional factors. For instance, both Ireland and Portugal had coalition executives led by center-right parties. Yet, Portugal delivered a relatively balanced adjustment, while Ireland delivered a consolidation primarily based on spending cuts.

Meanwhile, work on external pressures suggests that conditionality drives fiscal consolidation but is not necessarily crucial in determining the adjustment strategy. For instance, looking at Southern European countries before and after EMU accession, Blavoukos and Pagoulatos (2008, 248) claim that while the Maastricht eligibility criteria acted as a "push" factor leading governments to trim their budget deficit, the focus on nominal fiscal stabilization meant executives had enough freedom to choose the consolidation mix.[14] In most cases, executives used this flexibility mainly to increase revenues to avoid implementing politically difficult structural fiscal

[14] Once membership was achieved, however, the Stability and Growth Pact (SGP) proved unable to meaningfully constraint member states' fiscal policies (Baerg and Hallerberg 2016).

reforms touching politically sensitive such as public wages or social transfers (von Hagen, Hallett, and Strauch 2001, 7).

The literature on the Eurozone countries is unclear about whether governments retained such latitude to choose an adjustment strategy. Some authors have claimed that the terms included in the bailouts forced borrower governments to adopt the same set of policies defined by EU and IMF technocrats (Armingeon and Baccaro 2012; Blyth 2013; Matthijs 2017; Scharpf 2013), while others suggest that borrower governments retained some room for maneuver to make decisions on fiscal issues, among other areas. For instance, Hick (2018, 16) claims that "the Troika's focus on the deficit reduction targets and not (in the main) specific reforms meant (…) there remained scope to discuss the specific policies that would contribute to deficit reduction." Moury et al. (2021, 148) also argue that governments had leeway to design policy measures as long as they reached the general objectives agreed with the Troika. However, if executives were free to determine the strategy to reduce their budget deficits, we should have seen choices that reflected their partisan preferences. Conversely, if conditionality restrained governments so much that they did not have space to make policy choices, they should have delivered broadly similar adjustments, which was not the case.

I argue that the key to understanding fiscal consolidation strategies of borrower governments during the Eurozone crisis lies in jointly analyzing international pressures in the form of conditionality and domestic dynamics. Drawing from Putnam's (1988) two-level game framework, I show that all borrower governments initially pushed for expenditure-based consolidations, either because they shared the Troika's preferences on the matter or because they were forced to accept such a consolidation strategy. However, the prioritization of annual deficit targets in program

conditionality meant borrower governments were forced to raise taxes when faced with fiscal slippages due to factors outside their control, thereby failing to deliver an expenditure-based consolidation.

The two-level game framework conceptualizes international negotiations as the product of bargaining on two levels, the international (Level I) between two chiefs of government (COGs) trying to reach a deal, and the domestic (Level II), where the agreement needs to be ratified. In the case of Eurozone EAPs, we can assume that Level I negotiations take place between the Troika and the borrower-government as COGs, while the loan terms are "the deal" that needs to be approved. Meanwhile, while the Eurogroup and the IMF are the respective Level II fora for ratification of the agreement on the lenders' side, the domestic policy system of the borrower government determines whether the deal (essentially the implementation of the loan terms) can be approved on its Level II side.

According to Putnam's argument, international cooperation is only possible when the win-sets of both sides coincide, that is, when the range of agreements that each Level II constituency can ratify is compatible. An important factor determining win-sets' size is the cost of no agreement for Level II constituents, with higher costs leading to larger win-sets and, thus, a higher likelihood of an agreement being concluded (Putnam 1988, 442). At the same time, chief negotiators can try to expand their own as well as the other side's win-set using strategies, the choice of which is influenced by the COGs' preferences (Moravcsik 1993, 30). For instance, when a COG favors an agreement for its own sake, it might "collude" with the other side to include issues in the deal that might help it pursue its interests at home (Moravcsik 1993, 31; Putnam 1988, 451).

Applying these insights to the negotiation dynamics underpinning Eurozone EAPs, we can expect borrower governments that favor similar economic policies to those preferred by the EU and the IMF to use conditionality strategically to implement them at home (Lütz and Hilgers 2018, 1447). In line with the political economy literature on fiscal consolidations, we should see executives led by center-right parties or elected on an economically liberal platform to agree to loan terms on Level I that entail a consolidation primarily based on spending cuts on Level II. As for borrower governments led by center-left parties, they would prefer to cut their budget deficits mainly by raising taxes. However, their ability to push back against the lenders' demands is limited given the elevated cost of losing financial assistance, which significantly expands their win-set. This imbalance gives EU and IMF policy elites additional leverage to expand the win-set of the borrower government and push in conditionality negotiations for measures aimed at reaching the agreed annual deficit targets primarily via expenditure reductions, which is the EU and the IMF's preferred adjustment method as suggested in the first section of this paper. Therefore, we can hypothesize that conditionality will erase ideological differences regarding fiscal consolidation:

H1. Fiscal conditionality in EAPs will lead borrower governments to push for expenditure-based consolidations regardless of their ideological preferences.

However, sometimes deals agreed at Level I are not ratified at Level II, for instance, when a Chief of Government (COG) decides to defect from the agreement voluntarily. Involuntary defection is also a prominent feature of international agreements, where Level II constituents reject the deal against the preferences of the chief negotiators (Moravcsik 1993, 29; Putnam 1988, 439). A borrower government might indeed be unwilling to defect voluntarily from implementing EAP fiscal

conditionality as long as it depends on the lenders for funding. However, it might still face obstacles when implementing the loan terms. For instance, partisan or institutional veto players (Tsebelis 2002; Tsebelis and Chang 2004) might try to block certain measures, severely restricting the win-set of the borrower. Political parties might oppose the approval of spending cuts in parliament, or in the absence of such an option, they might use the courts as a strategic venue for contesting fiscal policy decisions (Saurugger and Fontan 2019).

Courts have been traditionally dismissed as veto players (VPs) because it has been assumed that their preferences are "absorbed" by other actors in the political system (Tsebelis 2002, 81). However, recent studies suggest that the preferences of constitutional judges might be less absorbed by other VPs than previously assumed (Brouard and Hönnige 2017). Moreover, courts can severely restrain the margin of maneuver of a country's chief negotiator (Alivizatos 1995; Lütz and Hilgers 2018). If a court strikes down spending cuts adopted to implement the loan terms, this will lead to the emergence of a fiscal gap with regard to the deficit targets the borrower government has agreed to reach.

A second source of involuntary defection under EAP conditionality in the case of fiscal adjustments is the quality of the economic forecasts underpinning the consolidation path specified in the loan terms. An oft-repeated argument about the crafting of IMF programs is that the Fund has tended to be too overoptimistic regarding the economic performance of borrowing countries (Baquir, Ramcharan, and Sahay 2005; Bird 2005).[15] In the case of the Eurozone, the fiscal rules underpinning conditionality heavily emphasize that borrower governments must reach the agreed

[15] On the Eurozone's tendency to make overoptimistic forecasts, see Frankel and Schreger (2013).

annual deficit goals. However, if the borrower country's economy performs worse than expected, this will also lead to fiscal slippages.

As long as a sovereign under an EAP does not have access to international bond markets, it has few options to cover a fiscal gap since the financial envelope attached to a program is fixed (i.e., it cannot be modified unless a new program is negotiated). Moreover, Eurozone decision-makers' reluctance to engage in debt restructuring limits the potential recourse to such a solution (Frieden and Walter 2017). Alternatively, the borrower government could ask creditors to give the country more time to meet deficit targets (a revision that would have to be financed in any case). However, the win-set of the Eurozone lenders was rather narrow when it came to fiscal conditionality, given the importance of moral hazard concerns for member states such as Germany (Bulmer 2014; Henning 2017; Matthijs 2016; Matthijs and Blyth 2018; Schimmelfennig 2015). In the absence of a substantial renegotiation of fiscal targets, the debtor government then has no choice but to cover the fiscal gap since the ultimate priority of EU institutions as monitors is for debtor countries to reach the SGP's nominal and statutory targets year by year and by the conclusion of their respective programs (Lütz, Hilgers, and Schneider 2019a, 14). The adopted measures will likely take the form primarily of tax hikes, which are perceived to be faster in bringing revenue (Alesina, Favero, and Giavazzi 2019, 160). Hence the second hypothesis:

H2. Eurozone borrower governments facing fiscal slippages will opt primarily for tax rises to meet deficit targets, thus failing to deliver expenditure-based consolidations.

To recap the proposed argument, EAPs are expected to initially erase ideological differences between borrower governments, as they will all agree to conditionality aimed to achieve expenditure-based consolidations. However, if a

borrower executive fails to reach the agreed deficit targets because of domestic political or economic constraints, then it will proceed to hike taxes to cover the subsequent fiscal slippage. This decision will consequently lead the government to fail to deliver an expenditure-based adjustment as initially planned.

2.4 Fiscal consolidation in three Eurozone countries

2.4.1 Case selection and method

To validate the proposed explanation, I compare the fiscal adjustment strategies of three of the five countries that implemented EAPs during the Eurozone crisis: Greece, Ireland, and Portugal. The chosen cases are diverse enough in that they capture a sufficient amount of variance among the relevant variables of study (Seawright and Gerring 2008, 301), with Ireland being the only country that delivered an expenditure-based consolidation. The research draws on semi-structured interviews with elite informants, including six former finance ministers and senior policymakers from the Greek, Irish and Portuguese governments, the European Commission, and the IMF. Some of the interviewees requested full anonymity, while others agreed for their names to be mentioned but asked not to be quoted directly. As a result, all contributions have been kept anonymous. The full list of interviews is provided in Appendix 1, and the interviews are referred to by codes. The information from the interviews is complemented by the analysis of policy documents such as the quarterly program reviews by the IMF and EU institutions, program evaluations, statements by key decision-makers, and insights from the secondary literature.

2.4.2 Fiscal consolidation in Greece

Greece's economic problems at the inception of its sovereign debt crisis in 2009 were manifold. These included declining competitiveness – with continued inflation differentials with the rest of the Eurozone – as well as a double-digit budget

and current account deficits (Desli and Pelagidis 2012, 152). However, the main trigger behind the country's financial distress that forced it into a bailout was mostly fiscal. The revelation by the Greek authorities that deficit numbers were considerably higher than what had been previously disclosed to EU authorities is widely considered the starting point of the Eurozone crisis (Pisani-Ferry, Sapir, and Wolff 2013, 54). Shortly after the victory of George Papandreou's center-left Panhellenic Socialist Movement (PASOK) party in the 4 October 2009 general election, Finance Minister George Papaconstantinou revealed that the budget deficit was three times larger (12.7% of GDP vs. 3.6%) than communicated by the previous New Democracy (ND) administration. Following additional calculations in April 2010, the figure would be raised to 13.6%. Greece's progressive loss of access to debt markets ushered in an arduous negotiation process with EU counterparts (Bastasin 2012; Blustein 2016; Henning 2017) that eventually led to the first bailout agreement in the Eurozone's history.

Initial negotiations

The 2009 election campaign – which pitted the then ruling center-right New Democracy (ND) of PM Kostas Karamanlis against PASOK – revolved mostly around economic concerns and political reform issues. ND focused on presenting Karamanlis as a "responsible figure" who would freeze salaries, pensions, and recruitment in the public sector to deal with the impending crisis. PASOK, in contrast, promised to inject EUR 3bn of fiscal stimulus, raise education expenditure by 5%, and tackle tax evasion as its main remedies (Gemenis 2010; Kovras 2010). Once in power, however, the PASOK government had to introduce significant consolidation measures in the 2009

budget to placate markets' fears of a sovereign default.[16] Towards the end of the year, Athens also worked with the EC to revise its Stability and Reform Program (interview 1407), including a medium-term fiscal consolidation plan for 2010-2013. The document stated that the adjustment to be implemented in 2010 would be 4% of GDP, with 2.6% coming from revenue and 1.4% from expenditure measures. For the following years, the strategy foresaw a balanced adjustment (Greek Ministry of Finance 2010a, 23).

Although conditionality negotiations shifted the consolidation balance in favor of trimming expenditure, Finance Minister Papaconstantinou believed that both spending cuts and tax measures were necessary:

> "The emphasis of the adjustment […] was on expenditure cuts (two-thirds compared to one-third coming from the revenue side) […] Cutting back on the public sector bill – the bulk of overall spending– was inescapable. The first wage cuts had been instituted before the bailout. Now on the negotiating table was the full suppression of the 13th and 14th salary of civil servants" (Papaconstantinou 2016, 190).

The government had to accept nominal cuts to pensions, among other measures, despite opposing them during the negotiations (Interview 1109). [17] In the end, the program established an expenditure-based adjustment to reach the initially agreed deficit targets (8% of GDP for 2010, 7.6% for 2011, 6.5% for 2012, 4.9% for 2013, and 2.6% for 2014). These goals were underpinned by macroeconomic projections estimating a contraction of 4% in 2010 and 2.6% in 2011 before returning to 1.1% growth in 2012 and 2.1% in 2013 and 2014, respectively.

Program implementation

[16] Al Jazeera (2009) *Greece moves to tackle debt crisis*, 14 December: https://www.aljazeera.com/news/2009/12/14/greece-moves-to-tackle-debt-crisis

[17] Some members of the government were generally opposed to the strategy of generating market credibility via fiscal measures (interview 1114), exposing the divided narratives about the crisis within the cabinet.

The Papandreou administration made substantial progress in the first months of the program, and the Troika praised the "impressive budgetary consolidation" in its first program review (European Commission 2010d). However, from the second review mission onwards, every program assessment stated that the government would not hit the deficit targets because of fiscal slippage. Since member states and the EU institutions kept rejecting the option of debt restructuring until late 2011 (Henning 2017) and with a relaxation of program targets off the table, the Troika consistently asked the Greek government to adopt additional measures to reach the agreed annual deficit targets (interview 1104).

As a result, the PASOK administration adopted several packages throughout 2010 and 2011 to cover the fiscal gap. For instance, an emergency bill and a yearly budget adopted in late 2010 included a reduction in short-term contracts in the public sector and an increased targeting of fuel subsidies and family allowances, as well as a reduction of health spending on drugs and a 10% reduction of wages of workers of State-owned Enterprises (SOEs) (European Commission 2010e, 14). A similar dynamic played out in the first half of 2011 when the Troika asked the Papandreou administration to introduce new measures as part of the Medium-Term Budgetary Strategy (MTBS), which would lay out the path to bring the deficit below 3% of GDP by 2014. The package included another round of spending cuts in public wages, social benefits, and several government departments' budgets. However, the bill also included a significant increase in excise taxes and VAT rates for food and drinks sold by restaurants and bars (from 13% to 23%); a reduction in the tax-free threshold; the introduction of a solidarity levy for high earners; and higher luxury levies.

The measures would not be the last package of the year. In the second half of 2011, the Troika asked the government for new measures to reach the deficit target in

2012. Parliament passed a new bill in October, which included cuts to the highest pensions, a new property tax collected through electricity invoices, the widening of the income tax base, and a further reduction of the tax-free income threshold (European Commission 2011b). This would be the last set of measures adopted before the institutions recognized debt restructuring and a second program would be necessary.

The available evidence suggests that the faster-than-expected collapse of the economy was the main factor causing Greece to miss its targets (European Court of Auditors 2017, 65; International Monetary Fund 2013a, 21).[18] In addition, the Troika reviews pointed to the government's limited progress in improving tax compliance and its difficulties in controlling expenditure (European Commission 2010e, 11, 2011d, 21; International Monetary Fund 2010b). Compared with other program countries, Greece experienced the highest level of political turmoil around fiscal consolidation under conditionality, with frequent public protests sometimes turning violent and the refusal of ND to cooperate with the government in parliament (Afonso, Zartaloudis, and Papadopoulos 2014; Karyotis and Rüdig 2018; Psimitis 2011). Nevertheless, political constraints were not a direct cause of fiscal slippages, as the government mustered the necessary support in parliament to implement the agreed consolidation packages despite the numerous defections by PASOK MPs (Gemenis and Nezi 2015).[19]

In terms of policy outcomes, the IMF estimated that tax changes ended up constituting half of the measures targeted for the first two years of the program (International Monetary Fund 2013a, 23). The change in focus was due to the urgency

[18] In fact, Greece's economic contraction triggered a debate between the IMF and the EU about "fiscal multipliers," or the estimated negative effect of consolidation measures on economic growth. See Cohen-Setton (2012) for an overview of the controversy.
[19] Eventually, Papandreou resigned following a failed attempt to call a referendum on the approval of the second program. His departure led to the formation of a technocratic administration headed by Lucas Papademos.

of fiscal targets, with increased taxation seen as "the fastest way of reaching the goals" (interview 1107). More importantly, the impact of tax rises was diffused across the electorate and did not affect groups such as public employees that constituted PASOK's core support base (interview 1109). The IMF's own evaluation of the program confirmed that "the case for indirect tax increases was that they were quick to take effect and faced less resistance than cuts in spending programs" (International Monetary Fund 2013a, 23).

The first bailout heavily influenced the menu of available consolidation options in future programs. Between 2010 and 2011, the government adopted fiscal measures equal to 17.2 of GDP (23.2% if the year 2012 is included in the calculation). In contrast, the second and third programs delivered fiscal consolidation measures for 11.9% of GDP (Pagoulatos 2018, 16). Still, partisan lines shaped fiscal consolidation to a certain extent. The second program (2012-2015), implemented by a coalition dominated by ND and supported by PASOK and the Democratic Left (DIMAR), put more emphasis on spending cuts.[20] In late 2012, for instance, the Antonis Samaras administration managed to approve a 2013 budget that included an adjustment of EUR 9.2bn, centered on cuts to pension and public wages, and represented two-thirds of the total adjustment for 2013-2014 (European Commission 2012d). A government led by the anti-austerity Coalition of the Radical Left (SYRIZA) and supported by the populist Independent Greeks (ANEL) implemented the third program (2015-2018). Yet, despite initial reluctance, the SYRIZA-led government maintained a primary surplus above 3.5% of GDP for most of the program years, with a consolidation mix balanced between cuts and tax rises (European Stability Mechanism 2020, 54).

[20] DIMAR left the coalition in June 2013 as a consequence of the closure of the public Hellenic Broadcasting Corporation.

2.4.3 Fiscal consolidation in Ireland

The coalition government of the center-right Fianna Fail party and the Green party applied for external financial assistance in the autumn of 2010 after a banking crisis generated by the bursting of a real estate bubble led to investors withdrawing from the country's sovereign debt. The EUR 85bn program agreed with the EU-IMF on 28 November 2010 foresaw a EUR 15bn consolidation effort for 2011-2013 with a frontloading of EUR 6bn in 2011, which the government announced in its "National Recovery Plan" (NRP). In fact, the Fianna Fail-Green government engaged in substantial fiscal adjustment before applying for financial assistance, having implemented several consolidation packages since the start of the crisis.

Initial negotiations

In February 2011, Fianna Fail lost the general election, and the center-right Fine Gael party, which obtained 76 *Teachtai Dála* (TD), formed a coalition government with the center-left Labour Party (37 TD) and five independents. Both Fine Gael and the Labour party had promised to renegotiate the terms of the EU/IMF program and, once in power, managed to extend the consolidation path by a year. The Irish EAP aimed to bring down the deficit to 10.6% of GDP in 2011, 8.6% in 2012, 7.5% in 2013, 5,1% in 2014, and 2.9% in 2015. The newly elected *Taoiseach* (prime minister), Enda Kenny, emphasized in his inaugural speech the importance of implementing the agreed fiscal consolidation plans to exit the EU/IMF bailout in time:

> "Closing the gap between tax revenue and expenditure requires painful but necessary decisions over the years ahead. It's important to emphasise that this gap exists independent of the banking sector - and must be closed if we are to return to the markets at the end of the EU\IMF program."[21]

[21] RTE (2011) *Enda Kenny's speech*, 15 March: https://www.rte.ie/news/2011/0315/298717-kennye_speech/

While both coalition partners were committed to delivering the agreed deficit targets, they held divergent views on the necessary extent of expenditure reductions. During the campaign, Kenny made clear that his administration would not increase corporation tax, which he considered a centerpiece of Ireland's competitiveness.[22] Another central promise of Fine Gael's electoral campaign was not to raise taxes and to use spending cuts for deficit reduction.[23] Finance Minister Michael Noonan also believed that past revenue-based consolidations had hurt growth (Leahy 2013, 245). As a result, party leaders pushed hard in the initial cabinet negotiations to establish a consolidation ratio skewed towards spending cuts from the outset because they believed Labour would eventually try to increase taxes to reach the adjustment goals (Interview 1601).

Labour's electoral program also vowed not to push for an increase in the 12.5% corporate tax, reflecting the consensus among Irish political and business elites around its importance in attracting foreign direct investment (Dellepiane-Avellaneda and Hardiman 2015; Kneafsey and Regan 2020; Regan and Brazys 2018). Aside from this issue, however, Labour believed that "the composition of the adjustment should be fairer and more balanced, including fairer taxation and ongoing investment in education and other vital services" (Labour Party 2011, 13). In his account of coalition negotiations, *Tánaiste* (deputy prime minister) and Labour leader Eamon Gilmore suggests that his party tried to negotiate a more balanced approach:

> "Fine Gael had contested the General Election arguing for a 3:1 ratio between spending cuts and new taxes. Labour argued for a 50/50 split, and while the

[22] The Guardian (2011) *Ireland will not give up low tax regime, Enda Kenny tells Angela Merkel*, 14 February: https://www.theguardian.com/world/2011/feb/14/ireland-fine-gael-corporation-tax
[23] The Guardian (2011) *Irish election frontrunner promises to drive down country's debt by 2014*, 15 February, https://www.theguardian.com/world/2011/feb/15/fine-gael-enda-kenny-debt-pledge

> Program for Government did not settle the issue, the assumption was that the ratio would be somewhere around 2:1." (Gilmore 2015, 194)."[24]

Thus, Fine Gael managed to impose its views on relying mostly on spending cuts to deliver the deficit targets agreed upon with creditors. There is limited evidence of the Troika using its leverage to shape the adjustment's composition, with the European Commission's ex-post evaluation claiming that "the focus on expenditure reduction reflected the Irish government's preferences" (European Commission 2015a, 13).

Program implementation

Overall, the government was able to stick to its consolidation plans as the program progressed. By the end of the EAP, the government had implemented an estimated EUR 6.0bn of measures in 2011, EUR 3.8bn in 2012, and EUR 3.0bn in 2013, corresponding to 3.5%, 2.25%, and 1.75% of GDP, respectively. Moreover, two-thirds of the adjustment came from spending cuts, as foreseen in the initial program documents (International Monetary Fund 2015, 30).[25] The government significantly reduced current expenditure by cutting social protection spending as a percentage of GDP from 14.7% of GDP in 2010 to 13.7% in 2013. It also reduced the compensation of public employees from 11.7% of GDP in 2010 to 10.7% in the same period. More significantly, 2010-2013 saw a significant drop in gross fixed capital formation, with capital spending falling from 3.4% of GDP in 2010 to 1.8% by the end of the program (International Monetary Fund 2015). As for revenue measures, one-third of the

[24] The "program for government" was the name of the coalition agreement negotiated by Fine Gael and the Labour party.

[25] According to Gilmore, the final outcome was closer to a 1.4:1 ratio (Gilmore 2015, 194). However, he does not clarify whether this includes the fiscal effort made by the government after exiting the EU/IMF program at the end of 2013. The evaluations of the IMF and the EC also confirmed that two thirds of the consolidation effort came from the expenditure side.

adjustment came from indirect taxes, with the remaining measures targeting direct taxes.

The government did not have to contend with any significant fiscal gaps during the program. From the first review onwards, the Troika would confirm in every assessment that Ireland was on track to hit the agreed deficit target for each year. Politically, the government was able to overcome potential constraints to its preferred fiscal consolidation path. For instance, fear by public sector unions of public backlash and a repetition of the unilateral wage cuts adopted by the previous administration enabled the signature of the Croke Park (2011) and Haddington Road (2013) agreements (Geary 2016, 136). Both deals gave public sector workers certain protections in exchange for the acceptance of policy changes such as, among others, cost-saving reforms, a reduction in public service staff numbers, and continued pay freezes.

The Fine Gael/Labour coalition did not have to face any significant legal or economic constraints that would have jeopardized its adjustment strategy. The most prominent legal cases launched against the government during the bailout period concerned the establishment of the ESM and the Treaty on Stability, Coordination, and Governance rather than the specific budgetary decisions of the government (Saurugger and Fontan 2019, 1019). Furthermore, the country's High Court had previously delivered rulings that gave the executive significant room for budget choices, reflecting the latter's traditional strength in the Irish constitutional order and a weak economic and social rights culture (Coutts 2017, 238). On the economic front, although Ireland's performance was worse than expected, “the deviations from the original projections were comparatively limited (…) and did not warrant revisions to the policy program” (International Monetary Fund 2015, 16).

2.4.4 Fiscal consolidation in Portugal

Portugal's decision to apply for financial assistance followed the deterioration of its financial situation in the first half of 2011. In March, the Socialist Party (PS) government of Prime Minister Jose Socrates failed to pass an austerity package (the so-called Fourth Pact for Stability and Growth or PEC IV) designed to calm financial markets and resigned. When sovereign funding costs reached unsustainable levels, an EU/IMF EUR 78bn program was agreed upon in May 2011. It included ambitious fiscal adjustment targets—a deficit of 4.5% of GDP in 2012 and 3% in 2013 (down from an estimated 9.1% in 2010), most of which were frontloaded during the program's first two years.

Initial negotiations

On 5 June, the opposition center-right Social Democratic Party (PSD) won a legislative election with 108 MPs, falling short of the necessary seats to reach an absolute majority (116 MPs in the 230-seat National Assembly). Soon after, the PSD announced a coalition government with the center-right Democratic Social Center-People's Party (CDS-PP) of Paulo Portas (24 seats). The PSD campaigned strongly in favor of economic reforms, with party leader Pedro Passos Coelho regularly stating that his party's electoral program went "well beyond the Troika's (program)" (Freire and Moury 2013).[26] The PSD had long criticized the PS for not cutting expenditures enough to reduce the budget deficit.[27] As for the CDS-PP's electoral program, the latter also emphasized reducing spending and criticized past tax hikes that helped finance "excessive public spending" (CDS – Partido Popular 2011).

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[26] Diario de Noticias (2011) *Pedro Passos Coelho: "Este programa está muito além do memorando de troika"*, 9 May 2011: https://www.dn.pt/dossiers/economia/portugal-pede-ajuda-externa/noticias/interior/este-programa-esta-muito-alem-do-memorando-de-troika-1847579.html
[27] RTP (2010) *Passos Coelho desafia Governo a governar*, 15 August: https://www.rtp.pt/noticias/politica/passos-coelho-desafia-governo-a-governar_n367851

Under the premiership of Passos Coelho, the government began implementing a program negotiated by the previous socialist administration that had accepted a consolidation mix where two-thirds would come from expenditure reductions, despite its initial resistance to spending cuts (European Commission 2011f, 18). That distribution was in line with the preferences of the new ruling parties: PSD policy elites believed that expenditure-based consolidations were "more virtuous" (interview 1207). In its second review, the EC emphasized that the government had adopted an ambitious 2012 budget to meet deficit targets "by means of solid structural measures, predominantly on the expenditure side" (European Commission 2011a, 16). The monitoring institutions' perception was that the government was implementing the program by conviction (interviews 1403 and 1407).

Program implementation

From the early stages of the program, the government had to contend with fiscal slippages, which emerged because of higher-than-expected spending, the reclassification of State-Owned Enterprises (SOEs) and Public-Private Partnerships (PPP)-related operations, the recording of previously unknown liabilities of the Madeira region, shortfalls in real estate sales, and lower non-tax revenue (International Monetary Fund 2011c, 4). The government suggested deficit targets should be reviewed. Still, given the resistance of the Troika and concerns about the negative effects of the move on credibility, it decided to push for more consolidation measures (interview 1204). To hit the 5.9% of GDP deficit target for 2011, Finance Minister Vitor Gaspar proposed to bring forward a previously planned increase in the Value Added Tax (VAT) on electricity and a one-off income tax surcharge, among other measures to contain expenditure. Moreover, the government transferred EUR 6bn in pension fund liabilities from the country's four largest banks to the state accounts.

Overall, these measures allowed the executive to reach the deficit goal without deviating from its preferred adjustment mix. This approach was reiterated in the 2012 budget, which included significant consolidation measures, such as the temporary elimination of summer and Christmas bonuses (13th and 14th monthly salaries) for civil servants and pensioners. In one of his regular meetings with President Anibal Cavaco Silva, Prime Minister Passos Coelho reiterated that the cuts were adopted because they were necessary to reduce expenditure and not to raise taxes further, as established in the MoU (Cavaco Silva 2018, 51). According to the Fund, the budget was "carefully balanced between expenditure (about two-thirds) and revenue measures" (International Monetary Fund 2011c, 13).

From mid-2012 onwards, however, the government had to contend with implementation difficulties. According to Finance Minister Vitor Gaspar, the main hurdles to a consolidation based on reducing spending were:

> “The implications of the ruling of the Constitutional Court (and) the pattern of (economic) adjustment taking place in Portugal (which) led to substantially lower tax revenue than foreseen” (Avilez 2014).[28]

The legal issues emerged when President Anibal Cavaco Silva and opposition MPs challenged some of the spending cuts before the country’s Constitutional Court, leading to the reversal of some of the government's major budgetary decisions. In July 2012, for instance, the Constitutional Court ruled that the cuts to the bonuses of civil servants and pensioners were unconstitutional because they violated the proportionality and equality principles (Cisotta and Gallo 2014, 91). In April 2013, the court rejected cuts to the 14th monthly wage of public servants and pensioners, the 90% cut of the 13th and 14th-month payments to pensioners, the 5% cut in sick-leave

[28] Translated from the Portuguese.

subsidies, and the 6% cut in unemployment subsidies. These rulings led to a fiscal gap of around 0.8% of GDP.[29] Moreover, the Troika recognized in the quarterly assessments the negative impact of negative macroeconomic factors on tax revenues and fiscal performance more broadly (European Commission 2012b, 13, 2013c, 17; International Monetary Fund 2012a, 15).

Creditors recognized these difficulties and the government's efforts and moved to relax Portugal's targets twice (interview 1403), in September 2012 and March 2013, setting the deficit objective for 2015 at below 5%.[30] The government still had to comply with the goals set under the EDP and adopt more measures under the pressure of the monitoring institutions. Meeting the agreed targets was also perceived by Portuguese decision-makers as key to recovering financial markets' credibility (interviews 1203 and 1204).

However, Gaspar thought that, given the constraints, the only way of reducing expenditure in the long-term would be through a comprehensive reform of public administration. The problem was that such a transformation would need more time than the timeframe established in the MoU and possibly more than one parliamentary term (Avilez 2014). Especially after the court rulings, the government believed that despite their preference for an expenditure-based consolidation and the fact that tax hikes would hit core PSD voters, there was "no space for ideology." Tax rises were the fastest way of reaching the deficit goals while minimizing the risk of future negative decisions by the judges (interviews 1207, 1209). As a result, when the Troika exhorted the government to adopt additional spending cuts in the 2013 budget, the executive

[29] For a comprehensive review of all the cases brought to the Court see Canotilho, Violante, and Lanceiro (2015).
[30] Reuters (2012) *EU, IMF give Portugal more time to meet deficit goals*, 11 September: https://www.reuters.com/article/us-portugal-bailout/eu-imf-give-portugal-more-time-to-meet-deficit-goals-idUKBRE88A17R20120911

responded that meeting deficit targets in time would only be possible through tax increases (Reis Pires 2015, 94).[31]

The targets' urgency led the government to introduce significant tax increases in the 2013 accounts, including, amongst other measures, a reduction from eight to five tax bands that pushed more taxpayers into higher bands, an increase in the average income tax rate, an income tax surcharge of 4%, and a hike in capital gains tax from 25% to 28%.[32] Additional measures adopted throughout the program to counter fiscal slippages included increasing the extraordinary contribution on pensions (CES) and the contribution to the special public sector health insurance schemes (European Commission 2014b, 22). The successive tax increases eventually led to abandoning the objective of an expenditure-based adjustment from 2013 (European Commission 2016d, 53).

It should be noted that political constraints forced the government to withdraw one of its flagship measures, the controversial "fiscal devaluation" (a cut of 5.75 points in employers' social security contributions to be compensated by a 7-point increase in workers' contributions), which led to widespread protests across the country (Accornero and Ramos Pinto 2015). Overall, the monitoring institutions acknowledged that the Constitutional Court rulings and macroeconomic issues played the largest role in pushing the government away from an expenditure-based consolidation (International Monetary Fund 2016, 32).

[31] The IMF also made clear later in the program that "additional revenue-mobilizing measures (were) not recommended" (International Monetary Fund 2013b, 12).
[32] BBC (2012) *Portugal reveals tough 2013 budget*, 15 October: https://www.bbc.co.uk/news/business-19953167

2.5 Conclusions

This paper has investigated the factors that lead borrower governments to choose a fiscal consolidation mix under Eurozone crisis lending conditionality. The evidence laid out in the case studies validates the hypotheses formulated under the two-level game framework proposed at the beginning of the paper. Greece, Ireland, and Portugal initially pursued expenditure-based adjustments in line with the EU's and the IMF's well-established preferences on the subject. However, worse-than-expected recessions in Portugal and especially Greece led to fiscal slippages that had to be swiftly compensated by alternative consolidation measures. In Portugal, this challenge was compounded by constitutional court rulings invalidating several spending cuts, some of which had been adopted by the government precisely to fill the emerging fiscal gaps related to economic underperformance. Given the urgency generated by annual deficit targets and the lenders' narrow win-set regarding fiscal matters, borrower governments opted for hiking taxes to quickly capture additional revenue, preventing these executives from delivering a fiscal adjustment primarily based on cutting expenditure. Put differently, implementation constraints made the goals of meeting annual deficit targets while delivering an expenditure-based consolidation incompatible. Eurozone bailouts essentially magnified pathologies previously identified by the literature on EMU fiscal conditionality (Blavoukos and Pagoulatos 2008). This outcome is why the loan terms can be described as the Maastricht criteria "on steroids." The focus on deficit targets led governments to follow the quickest path, which was also that of least resistance, to meet the agreed goals.

The paper contributes to the literature on fiscal consolidation in the Eurozone by showing that stringent conditionality erases ideological differences between governments regarding the composition of fiscal consolidation, as predicted by the

paper’s first hypothesis. Center-right governments pursue expenditure-based consolidation in line with their well-established preferences (Castles 2007; Mulas-Granados 2006; Tavares 2004), while left-wing executives are forced to do the same due to the asymmetry of power that underlies conditionality and the preference of the lenders for adjustments based on spending cuts. However, as expected by the paper's second hypothesis, even center-right governments give up on implementing their preferred adjustment strategies when facing obstacles to consolidation in the context of tight deficit targets. While executives might have initially had some leeway to design consolidation measures as claimed by the literature (Hardiman and MacCarthaigh 2013; Hick 2018; Moury et al. 2021), this margin of maneuver was reduced to choosing from a rather restricted set of measures when covering fiscal slippages to reach deficit targets became fiscal policy’s primary goal.

The insights from the paper add to recent calls in favor of granting greater importance to the study of program design when trying to understand the impact of external economic conditionality on domestic policies (Reinsberg, Stubbs, and Kentikelenis 2021). Certainly, the generalizability of the paper’s insights to other cases of external conditionality, such as in non-EU countries, is constrained by the specificity of EU fiscal rules. Nevertheless, research beyond Europe could explore, for instance, whether the setting of overoptimistic fiscal goals in IMF programs and implementation constraints exercise a similar effect on the ability of borrowing governments to deliver an adjustment in line with their preferences.

Finally, the paper’s findings inform the debate on the reform of EU economic governance, which, over the last decade, has become increasingly restrictive with more stringent fiscal rules seen to prioritize "responsibility" towards Eurozone counterparts over "responsiveness" towards electorates (Doray-Demers and Foucault 2017). The

case studies show that setting over-optimistic fiscal goals can significantly undermine the "ownership" of fiscal adjustments by national governments, making their execution even more challenging. More importantly, the paper also suggests that excessively constraining fiscal targets can hinder executives' ability to implement "responsible" policies by delivering consolidations heavily based on revenue increases, which the economics literature considers to be less sustainable in time (Buti and Sapir 1998; Perroti, Strauch, and von Hagen 1998). Excessively stringent fiscal rules, in other words, might undermine the very objective they are trying to achieve in the long term.

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3 - *Bonds, Ballots, and Tied Hands: The Politics of Labor Reform under Conditionality in Portugal*

Abstract

Several studies on economic conditionality claim executives sometimes tie their hands to the external constraint provided by conditionality to force reforms at home. In contrast, other scholars suggest borrower governments use domestic constraints to extract concessions in conditionality negotiations. How can these two seemingly contradictory predictions be reconciled? Looking at the case of Portugal during the implementation of its Economic Adjustment Program (2011-2014), I argue that reform-minded executives tie their hands vis-à-vis domestic constraints when the cost of no agreement is high, and they face a low risk of being replaced. However, strong domestic constraints translate into hand tying vis-à-vis the international lenders when electoral risks rise for the government and the perceived cost of forgoing financial assistance decreases. Therefore, it can be argued that the willingness of a reformist government to use conditionality ends where its electoral concerns begin. The article makes a contribution to the literature by specifying the factors that shape borrower governments' strategic behavior under conditionality.

3.1 Introduction

The economic crisis that hit the Eurozone at the beginning of the decade endowed EU institutions with unprecedented power to shape the economic policies of member states under financial distress. Traditionally the preserve of organizations like the IMF, the ability to impose policy conditions in exchange for financial support significantly increased the intrusiveness of the EU in domestic policy-making areas, such as labor markets (de la Porte and Heins 2014; Theodoropoulou 2014). Several studies on the so-called Eurozone bailouts argue that this constraint afforded "reform-minded" executives an opportunity to override domestic opposition to reform and push for market-friendly policy changes they have always wanted to implement (Freire and Moury 2013; Lütz, Hilgers, and Schneider 2019b; MacCarthaigh and Hardiman 2020; Moury et al. 2021; Moury and Standring 2017). At the same time, other accounts argue that borrower governments sometimes pushed back against the international lenders' demands, even if the success of such a strategy had varying degrees of success (Lim, Moutselos, and McKenna 2019; Zahariadis 2017).

These claims echo arguments made by the literature on IMF programs, with several studies suggesting that conditionality strengthens the hand of executives that want to implement policy reforms vis-à-vis domestic opposition (Drazen 2002; Putnam 1988; Rogers 2009; Vreeland 2003a). However, other scholars contend that borrower governments sometimes use domestic political constraints to obtain a better deal in conditionality negotiations (Caraway, Rickard, and Anner 2012; Rickard and Caraway 2014). To reconcile these two seemingly contradictory predictions, I draw from the two-level game framework of Putnam (1988) and claim that electoral concerns and bargaining power shape the strategic behavior of borrower governments. Reform-minded executives tie their hands vis-à-vis domestic constraints when the cost

of no agreement is high, and they face a low risk of being replaced. However, strong domestic constraints translate into hand tying vis-à-vis the international lenders when electoral risks rise for the government and the perceived cost of forgoing financial assistance decreases. The paper is the first study (to my knowledge) to reconcile two of the main claims made by the conditionality literature regarding the strategic behavior of borrower governments.

To illustrate this argument, I conduct a cross-time case study of the implementation of labor market conditionality in Portugal under its Economic Adjustment Program (2011-2014). The Iberian country can be considered a deviant case (Rohlfing 2012) for theoretical predictions about the strategic use of domestic constraints, as the loan terms agreed under its bailout were executed by a government elected on an economic liberalization platform (Magalhães, 2012). Therefore, the government should have been reluctant to use domestic constraints to extract concessions in conditionality negotiations. However, the implementation of labor reforms during the bailout period suggests such was not the case. While during a first phase, from June 2011 to early 2013, the government introduced extensive labor market reforms, during a second period between 2013 to May 2014, the government pushed back against the lenders' demands to implement additional policy changes (Reis Pires 2015).

The cross-time single-case study relies on the analysis of semi-structured elite interviews with decision-makers. It makes an empirical contribution to the study of reforms under Eurozone conditionality by exploring the perceptions of key figures in the Portuguese government who were directly in charge of negotiating and implementing the program's loan terms. This analysis is complemented by data from interviews with EU and IMF officials involved in conditionality negotiations. The

information from the interviews is triangulated with official documents such as the quarterly program reviews from the monitoring institutions, ex-post evaluations of the programs by different organizations, national policy documents, press content, and first-hand accounts.

The paper contributes to the literature by specifying the factors that shape the strategic behavior of governments under conditionality. Reform-minded executives have an incentive to "collude" with the international lenders to pass reforms at home when they face resistance from domestic actors. However, politicians face different incentives from international bureaucrats as, in addition to making policy, they also seek to stay in office (Müller and Strøm 1999). Therefore, the willingness of reformist governments to use conditionality strategically arguably ends where their electoral concerns begin.

The paper proceeds as follows. It starts by outlining the puzzle through a review of the outputs of labor market reforms under conditionality in Portugal. Next, it reviews the existing literature and proposes an alternative analytical framework based on the two-level game framework. The third section of the article lays out the evidence from the case study, which is followed by a discussion of the results of the analysis and the presentation of the conclusions.

3.2 Labor reforms under conditionality in Portugal

International Financial Institutions (IFIs) such as the IMF have traditionally seen certain aspects of labor market institutions, such as greater employment protection or labor taxes, as potentially conducive to worse employment outcomes (Emmenegger, 2009; International Monetary Fund, 2003, p. 137). Given the liberal market orientation of the Economic and Monetary Union (EMU) project (McNamara, 1998), Eurozone

policymakers have tended to broadly espouse a similar approach. For instance, the ECB stated in the early EMU years that employment protection measures and centralized wage bargaining– as well as minimum wage provisions and area-wide collective bargaining agreements – could potentially prevent labor markets from adjusting to the changing economic conditions (Duisenberg, 2003).

The IMF's position on labor issues has led the organization to frequently include policy conditions in its assistance programs aimed at deregulating borrower countries' jobs market (Mosley and Singer 2015). In the case of Eurozone bailouts, the loan terms included in Economic Assistance Programs (EAPs) resembled the loan terms of the Fund's Structural Adjustment Programs (Greer, 2014). Southern European borrower countries were expected to implement reforms to make their labor markets more flexible and achieve internal devaluation that would increase the competitiveness of their economies, given their inability to use currency depreciation as an adjustment tool (Armingeon and Baccaro 2012; Theodoropoulou 2014). An issue of particular concern for EU/IMF policymakers was the segmentation of certain countries' labor markets between "insiders" who enjoy higher levels of job security and employment rights than "outsiders" who are usually on fixed-term contracts or no contracts at all.[33] The European Commission argued early in the crisis in favor of reforming employment protection legislation "to reduce over-protection of workers with permanent contracts, and provide protection to those left outside or at the margins of the job market" (European Commission, 2010a, p. 7).[34]

In the case of Portugal, the EAP was implemented by a center-right coalition with a strong parliamentary majority elected on a market-friendly platform and

[33] Labor market dualism can be essentially understood as the vulnerability to unemployment of different types of workers (Rueda 2005, 2006, 2007; Rueda, Wibbels, and Altamirano 2015).
[34] See also European Commission (2012, 4,96).

promising to “go beyond” program conditionality regarding structural reforms (Freire and Moury 2013; Magalhães 2014, 181). Therefore, there was *a priori* a high degree of alignment between the international lenders and the authorities of the borrower country regarding the implementation of structural reforms. However, while the Portuguese government implemented deep changes to the country’s labor market rules, it did not go as far as the international lenders wanted. An example can be found in the reform of employment protection levels (EPL), with the IMF claiming that “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, p. 24).

Meanwhile, while a Commission’s assessment praised the government’s efforts to reduce job security levels for permanent contracts, it also suggested that compensation for unfair dismissals remained high after the program and that the government had decided not to explore policy changes regarding this issue despite being asked to do so by the lenders (European Commission, 2016a, p. 77). A report by the European Court of Auditors delivered a similar overall verdict about the reforms adopted by the Portuguese executive, stating that: “Portugal was asked to prepare a proposal to align severance payments with the EU average instead of with the set of countries that represent Portugal’s competitors in international trade. Then, during the programme, the less ambitious reforms were taken” (European Court of Auditors 2015, 65).

Patterns of reform under conditionality in Portugal followed two distinct periods. During a first phase (June 2011 to early 2013), the government introduced extensive reforms to employment protection levels (EPL), as well as to collective

bargaining, unemployment benefits, and active labor market policies, among other issues. In contrast, during a second period (early 2013 to May 2014), the government refrained from implementing significant labor market reforms despite the pressure from international lenders, which wanted further policy changes in areas such as EPL and minimum wages (Reis Pires 2015). The next section explores existing answers to the puzzle posed by this variation in the government's behavior and proposes a potential alternative explanation.

3.3 Strategic behavior of Eurozone governments under conditionality

A long-standing claim of the literature is that governments sometimes use economic conditionality strategically to push through unpopular economic reforms at home (Drazen 2002; Mayer and Mourmouras 2008; Putnam 1988; Vaubel 1986; Vreeland 2003a). A broadly similar argument has been made from the EU perspective, with the literature highlighting the strategic use of external constraints such as membership in the European and Monetary Union to impose domestic economic reforms (Featherstone and Dyson 1996). Several studies have applied this argument to the implementation of Eurozone bailouts, with scholars claiming that right-wing executives took advantage of the opportunity afforded by the loan terms to implement policy changes that they had traditionally favored (Asensio and Popic 2019; MacCarthaigh and Hardiman 2020; Moury and Standring 2017). For example, Lütz, Hilgers, and Schneider (2019b) claim that, as reform-oriented governments, the Cypriot and Portuguese executives effectively transferred the pressure from the Troika and financial markets onto domestic veto players through coercive negotiation strategies. Looking specifically at the case of labor reforms in Portugal, Branco and Cardoso (2020, 14) contend that, following an initial phase of cooperation with the opposition and trade unions, the Portuguese executive "aligned its preferences with the

Troika," using conditionality to impose neoliberal reforms. However, these studies do not explain why a reform-minded government elected on a market-friendly platform would resist pressures to further reform the country's labor market, given its expected alignment with the international lenders.

At the same time, the scholarship on economic conditionality also claims that borrower governments sometimes use domestic constraints to obtain a better deal in their negotiations with the international lenders. For instance, some studies suggest that democratic governments facing powerful labor interests at home can negotiate more lenient labor market reform conditions with the IMF (Caraway, Rickard, and Anner 2012). In the same vein, it has been argued that the proximity of elections to program negotiations gives governments additional clout to obtain less restrictive policy prescriptions (Rickard and Caraway 2014). In the case of the Eurozone, there is evidence that some governments tried to use domestic constraints to get an advantage in their negotiations with the Troika (Zahariadis 2017). Nevertheless, such a strategy tended to be ineffective given the high cost of no agreement for borrower countries, which were able to exercise some leverage in negotiations when their economic weakness made the program untenable (Lim, Moutselos, and McKenna 2019). Moury et al. (2021, 150) also suggest that several factors gave certain borrower governments some bargaining leverage in conditionality negotiations, such as the urgency of striking a deal, the costs of no deal for the lenders, borrower governments' credibility vis-à-vis the international lenders, their insider policy knowledge, and the saliency of the relevant policy issues for the lenders.

While insightful, these studies do not specify the conditions under which a government will behave in one of the two ways predicted by the literature. To account for how borrower governments act strategically under conditionality, I develop an

explanation based on the two-level game framework of international negotiations (Kahler, 1993; Putnam, 1988). This approach sees national governments as mediators between external and internal pressures during international negotiations (Cohen, 2008, p. 128). The core assumption is that the "Chiefs of Government" (COGs) can manipulate international and domestic politics concurrently or sequentially to obtain an advantage in negotiations (Moravcsik, 1993). On Level I, the COG of a borrower government interacts with the international lenders to reach an agreement on the loan terms. On Level II, the COG interacts with the domestic constituencies that must ratify the agreement. An agreement is only feasible when the range of acceptable outcomes on Level I (international negotiation) intersects with the array of policies that can be ratified on Level II (domestic ratification).

The size of the win-set at Level II is determined by the existing ratification procedures, the preferences of the constituents required to approve the agreement, and the strategies of both the COG and the negotiators of the opposing side to expand domestic win-sets (Lütz and Hilgers 2018, 3). In the case of IMF-style programs, "ratification" of the deal by the borrower government can be understood as the implementation of the bailout terms agreed with the international lenders. To facilitate ratification at Level II, a COG can deploy two types of strategies. First, it can claim its domestic win-set is constricted to extract better deal terms on Level I, or it can try to expand the domestic win-set to facilitate the ratification of the agreement (Putnam 1988, 440; Tarar 2001).[35] Governments can develop either "hard" or "soft" tactics, with a "tied hands" tactic being considered coercive bargaining (Dür and Mateo 2010a; J. S. Odell 2000; Zahariadis 2017). A tied hands tactic is indeed one in which

[35] See also Schelling (1960).

"actors signal that they cannot move towards others as they cannot change or adapt their positions" (Panke, Polat, and Hohlstein 2021).

According to the literature, reform-minded executives develop coercive strategies toward domestic actors to push reforms through at home when the cost of no agreement is high, which substantially narrows their win-set (Lütz, Hilgers, and Schneider 2019b). In the case of EAPs, the cost of no agreement is determined by the availability of sovereign financing options outside the international lenders, also known as the best alternative to a negotiated agreement (Raiffa 1982). When a sovereign is struggling to obtain funding in financial markets, forgoing financial assistance can lead to a default and, in the case of Eurozone countries, an exit from the common currency area. In other words, the cost of no agreement being lower for the government the higher its ability to access sovereign debt markets (Finke and Bailer 2019; de la Porte and Natali 2014). Moreover, a negative appraisal by international lenders of the government's implementation of the program can entail negative reputational costs vis-à-vis financial markets (Simmons 2000). As a result, it is easier for a reformist government to signal credibly to domestic audiences that its hands are tied when the existing best alternative to implementing the program does not look very attractive.

On the other hand, an improvement in the government's best alternative to a negotiated agreement (hereafter BATNA) can lead executives to try extracting concessions in international negotiations (Mckibben 2013). In the case of borrower governments, strong domestic constraints can turn into hard bargaining and "tied hands" towards the international lenders when the government perceives it has better financial alternatives to the assistance provided by its creditors (Zahariadis 2017). Therefore, we can theorize that the borrower government's BATNA shapes its

incentives differently when it comes to its strategic behavior towards domestic and international actors:

H1a. The worse the BATNA, the more likely a borrower government will use conditionality to tie its hands vis-à-vis domestic actors when facing domestic constraints to reform.

H1b. The better the BATNA, the more likely a borrower government will use domestic constraints to tie its hands vis-à-vis the international lenders.

Besides the cost of no agreement, borrower governments are also likely to take into consideration political factors when deciding how to act strategically under conditionality. In addition to policy goals, politicians are also office-seeking; in other words, they want to be in power (Meyer and Wagner 2014; Müller and Strøm 1999; Pedersen 2012). Therefore, governments face electoral risks, which can be defined as "the risk of government parties being replaced in office if voters are dissatisfied with government policy" (Hübscher and Sattler 2017, 153). These concerns play a crucial role in a government's decision to pursue certain policy changes. For instance, executives tend to avoid adopting unpopular measures such as fiscal consolidation towards the end of their legislative term (ibid.)

Some of the reforms usually promoted by IMF-style conditionality can also negatively affect specific groups of voters. For example, the freezing or reduction of minimum wages can have an immediate impact on certain workers' income, while reducing job protection levels makes employment more precarious (Rickard and Caraway 2014). Moreover, labor strikes are known to hurt an executive's re-election prospects (Hamann, Johnston, and Kelly 2016). Consequently, the more the implementation of reforms increases the electoral risk for the government, the less

willing it will be to use the external constraint provided by conditionality to impose policy changes at home in the face of domestic constraints. Furthermore, as the risk of being replaced by other parties increases, the government will be more willing to develop a tied hands strategy towards the international lenders to avoid implementing policy changes that will hurt its chances of being re-elected. Hence the following hypotheses:

H2a. The lower the electoral risk a borrower government faces, the more likely it will use conditionality to develop a tied hands tactic towards domestic actors when facing resistance to reforms.

H2b. The higher the electoral risk a borrower government faces, the more likely it will use domestic constraints to reform to develop a tied hands tactic towards the international lenders.

To summarize, reform-minded executives tie their hands vis-à-vis domestic constraints when the cost of no agreement is high, and they face a low risk of being replaced. However, strong domestic constraints translate into hand tying vis-à-vis the international lenders when electoral risks increase for the government and the perceived cost of forgoing financial assistance decreases. The dependent variable of the explanatory framework is dichotomous, meaning it is measured in terms of whether a government develops a tied hands tactic or not. In dealing with implementation constraints, we should expect to see a government deploying a tied hands tactic when they include policy changes they favor in the loan terms during conditionality negotiations or when using external pressures to justify policy changes vis-à-vis the relevant domestic actors. As for the negotiations with the international lenders, a tied

hands strategy will be one in which the borrower government appeals to domestic constraints when trying to obtain better loan terms.

Regarding the independent variables, I measure the BATNA of a borrower government in terms of its access to financial markets; that is, the higher the ability of the sovereign to tap markets for funding, the higher its BATNA. To that end, I use 10-year sovereign bonds as a proxy for the government's ability to obtain private sovereign financing. Meanwhile, I use voting intentions polls as a proxy for the risk that a government faces of being replaced by opposition parties. I assume that the higher the distance between the ruling party and the main opposition party and the closer the next legislative election, the higher the risk for the borrower government.

The next section tests the formulated hypotheses by conducting a cross-time study of labor market reforms under conditionality in Portugal under its EAP. It focuses on two policy areas that were of particular interest to the center-right coalition government that implemented the bailout: the reduction of employment protection levels and the reform of collective bargaining.

3.4 Labor market reforms under conditionality in Portugal (2011-2014)

3.4.1 Background

As in the case of other rescued Eurozone countries, Portugal was the victim of a balance of payments crisis triggered by a "sudden stop" of capital inflows (Copelovitch et al., 2016). Following Ireland's application for financial assistance in November 2010, the Iberian country had been flagged by financial media as the "next in line" in the chain of countries that might receive support from the EU and the IMF.[36] The Socialist Party (PS) government of Prime Minister Jose Socrates had, until that point,

[36] Financial Times (2010), *Insolvent – Greece, Ireland, Portugal and probably Spain*, 30 November: https://ftalphaville.ft.com/2010/11/30/420606/insolvent-greece-ireland-portugal-and-probably-spain/

adopted several adjustment measures to try placating financial markets. However, in March 2011, a new austerity package prepared by the government and designed in coordination with the EC and the ECB was rejected by parliament (the so-called Fourth Pact for Stability and Growth or PEC IV), leading to Socrates' resignation and the calling of early elections. With significant refinancing needs on the horizon and funding costs reaching unsustainable levels, the caretaker socialist administration was forced to apply for financial assistance from its Eurozone counterparts and the IMF on 4 April.

While deficit reduction featured prominently in the negotiations between Lisbon and the international lenders, the discussions also revolved around implementing supply-side reforms to make the economy more competitive. In addition to high public and private debt levels, as well as one of the most leveraged banking systems in Europe, the country had gone through a decade-long economic slump before the crisis (Reis 2013, 2015). The Commission did believe that low growth was Portugal's main economic problem (interview 1404), which led the institution to emphasize the need to address structural challenges to boost exports and potential long-term growth in the bailout talks (Henning 2017, 124).

3.4.2 Initial conditionality negotiations

In the two decades that preceded the crisis, governments from both sides of the political spectrum in Portugal had traditionally pursued tripartite agreements to legitimate economic reforms, even when they had large majorities in parliament (Campos Lima and Naumann 2011). Moreover, the historical division of the Portuguese labor movement into two rival unions, the General Confederation of Portuguese Workers (CCTP) – with close ties to the Communist Party (PCP) – and the General Union of Workers (UGT) – more aligned with the Socialist Party (PS) and the

PSD – has traditionally given UGT veto power in negotiations (Branco and Cardoso 2020).

Against this background, the socialist administration resorted to social concertation in late 2010 and early 2011 to push forward a series of changes to labor market rules designed to increase the country's competitiveness and help restore its external credibility.[37] In March 2011, the PS government concluded a tripartite agreement with UGT, the Confederation of Portuguese Industry (CIP), the Confederation of Farmers of Portugal (CAP), the Confederation of Trade and Services of Portugal (CCP), and the Confederation of Portuguese Tourism (CTP) (Economic and Social Council 2011).

The deal helped set the Portuguese government's initial position in the negotiations with the Troika. Minister of Labor Helena Andre wanted the loan terms to reflect the policy changes agreed upon under the social pact, which included a planned reduction in dismissal costs for open-ended contracts from 30 days per year of tenure to 20 days, limiting payments at 12 months of pay. The deal also stipulated the creation of an employer-financed fund to cover the cost of dismissals (Economic and Social Council 2011, 26). The Troika wanted the government to go further on a wide range of labor issues. Still, Lisbon pushed back, arguing that doing so would undermine the social consensus reached through the tripartite agreement (interview 1206) (Dinis and Coelho 2012, 215). The government was keen on developing a tied hands strategy to send a strong signal that they could resist the demands from the

[37] Reuters (2010) *Portugal labour reform unlikely to be far-reaching, 20 November*: https://www.reuters.com/article/portugal-labourmarket-idUKLDE6AS1PK20101129

Troika (interview 1206), which was a logical tactic given the PS was trailing the PSD in opinion polls by several percentage points ahead of the imminent elections.[38]

The agreed compromise saw the Troika accepting to formulate conditionality on labor reforms in a rather broad manner (interview 1403). For instance, regarding employment protection reforms, the loan terms stipulated that the government would have to prepare a proposal aiming at "aligning the level of severance payments to that prevailing on average in the EU" by the first quarter of 2012. The MoU also prescribed the reduction of dismissal costs for fixed-term contracts and a commitment to make changes to the definition of fair dismissal in the Labor Code "with a view to fighting labour market segmentation and raise the use of open-ended contracts" (European Commission 2011f, 79). Regarding collective bargaining, the initial document established that the government would "promote wage developments consistent with the objectives of fostering job creation and improving firms' competitiveness with a view to correct macroeconomic imbalances" (ibid. 80). These included prescriptions such as freezing the minimum wage, decentralize collective bargaining or adopting legislation to define the criteria for the extension of collective bargaining agreements.

3.4.3 First phase of labor policy under conditionality (mid-2011 – mid-2013)

Following the legislative elections of June 2011, a coalition was formed by the center-right Social Democratic Party (PSD) and the Democratic Social Center-People's Party (CDS-PP), which held a large majority in the Assembly of the Republic (132 MPs in the 230-seat chamber). Newly elected Prime Minister and PSD leader Pedro Passos Coelho appointed Alvaro Santos Pereira, an economics professor, to the Minister of Economy, Labor, Transport, Public Works and Communications, with

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[38] Eurosondagem (2011) *Estudo de Opinião*, April: https://www.erc.pt/download/YToyOntzOjg6ImZpY2hlaXJvIjtzOjQxOiJtZWRpYS9zb25kYWdlbnMvb2JqZWN0b19vZmZsaW5lLzE1Ny4yLnBkZiI7czo2OiJ0aXR1bG8iO3M6OToicmVsYXRvcmlvIjt9/relatorio

responsibility for implementing the labor reforms stipulated in the MoU. Two cabinet members confirmed in interviews that they shared the Troika's view that the labor market needed to be made more flexible by reducing dismissal costs and that collective bargaining needed to be liberalized to accelerate the country's economic recovery (interviews 1208, 1209).

The government's first decision to implement the agreed policy prescriptions was to adopt a draft bill that translated into policy the reduction in dismissal compensation for open-ended contracts (from 30 to 20 days, capped at 12 months of pay or 240 times the minimum salary) included in the March 2021 tripartite agreement.[39] The bill was approved by a large majority in parliament in October. Since the MoU established a staggered approach to bring dismissal compensation in line with the EU average, the government had to prepare proposals to implement a further reduction in firing costs, as well as to introduce adjustments to the cases for fair individual dismissals. One senior member of the government acknowledged that the Troika conditionality helped in terms of providing the initial drive to bring firing costs down. However, he also thought that the policy changes would have to be negotiated with producer groups to reduce resistance to reforms:

> "It was very important to get a social agreement so labor reform was less contentious. Ten years earlier, the government had tried to implement labor reforms unilaterally and there were massive demonstrations. An agreement would help us minimize the risk of conflict with the trade unions. I also thought that adopting policy changes under social consensus would be good for the external credibility of the country" (interview 1209).

However, the initial fiscal measures approved by the government to fulfil the program's deficit targets did not bode well for the conclusion of a tripartite agreement. Following the announcement by Finance Minister Vitor Gaspar that the budget for

[39] Law 53/2011.

2012 would temporarily eliminate the 13th and 14th monthly salaries for civil servants and pensioners, the CGTP and UGT organized a general strike in November. Moreover, other members of the government had negotiated with the Troika an increase in daily working time by half an hour, which trade unions strongly opposed (Branco and Cardoso 2020, 10). The move illustrates how different ministers within the cabinet sometimes pushed for conflicting priorities when it came to implementing the loan terms.

In an effort to get the unions back on board, Santos Pereira managed to obtain the support of Prime Minister Passos Coelho to withdraw the planned increase in daily working time (Santos Pereira 2014, 76–78). The government's perception was that it could get the unions to sign a tripartite deal by dropping proposals that threatened to implement more radical employment protection reforms and by offering to withdraw the abovementioned proposal to enact an additional 30 minutes of working time (interview 1209). CGTP did not accept the proposed compromise, and UGT felt that the agreement tipped the balance of labor relations strongly in favor of the employers. However, UGT ultimately decided to endorse the agreement to limit as much as possible the reach of the proposed policy changes (Campos Lima and Abrantes 2016, 27; UGT 2012). The UGT's support paved the way for the signature of a tripartite agreement between employers' organizations and UGT on 18 January (Economic and Social Council 2012).

The agreement covered most of the policy changes agreed on in the loan terms, including issues such as collective bargaining, active labor market policies, and educational and vocational training. Regarding job security regulations, the deal stipulated that the reduction in dismissal costs introduced by Law 53/2011 would apply to contracts signed before November 2011, albeit maintaining the level of

compensation for the time worked before that date (Economic and Social Council 2012, 45). It also acknowledged that the government would present proposals to further align compensation costs with the EU average from 1 November 2012, "at no detriment to the protection of the expectations of workers up to that moment" (ibid. 46).[40] Moreover, the agreement contained new rules for the definition of individual dismissals. These included eliminating the obligation to obey a tenure rule in cases of job extinctions on economic and technological reasons, expanding the ability of the employer to dismiss workers based on the unsuitability of the job, and the removal of the obligation for the employer to find an alternative position for the employee within the firm (ibid. 44). The agreement also allowed for the decentralization of collective bargaining by permitting work councils in firms with at least 150 workers to negotiate firm-level agreements (ibid. 51).

The contents of the agreement were immediately translated into a bill that became law 46/2012, which, according to the Troika, was in "broad compliance with the MoU" (European Commission 2011a, 30). However, cooperation between the Portuguese executive and the social partners would soon turn into confrontation as the government still had to pass legislation to define the criteria for the extension of collective agreements and adopt further measures to bring dismissal costs further in line with the European average.

Regarding collective bargaining, the first and second reviews of the EAP stipulated that the government would collect data on the representativeness of social partners to establish the criteria. Still, the MoU did not establish a representativeness threshold (International Monetary Fund 2011c, 2011b). This changed with the

[40] Translated from the Portuguese.

program's third review in April 2012, when the government agreed with the Troika to introduce legislation by which a collective agreement could not be extended when subscribed by employer associations representing less than 50% of workers in a sector (International Monetary Fund 2012b, 108). Such a move elicited strong resistance not only from trade unions but also from employer confederations, which felt the measure would significantly undermine collective bargaining (Bulfone and Afonso 2020, 834; Campos Lima and Abrantes 2016, 24).

Nevertheless, the government was determined to push for it, as expressed by a member of the cabinet in one of the interviews:

> "We believed that the extension of collective agreement should be based on the representativeness of the social partners as we thought it would push firms to reach firm-level agreements. The MoU was initially not very clear on what the concept of representativeness meant. Therefore, we had to develop it ourselves. We thought that if employers' associations represented more than 50% of workers in a sector, you might regard that as representative" (interview 1208).

As a result, the government introduced the measure in the loan terms as a condition that would have to be implemented despite the resistance of the social partners, suggesting the deployment of a tied hands tactics toward domestic actors. Moreover, in a parliamentary hearing that took place in July, Santos Pereira stated that, while the government would try to respect the Tripartite Agreement, the MoU still required the country to revise the criteria underpinning collective bargaining, particularly with regard to representativeness.[41] The government eventually implemented the abovementioned criteria regarding the extension of collective agreements via a resolution adopted in October of the same year (Branco and Cardoso 2020, 15).[42] In response to the measure, the country's main employers' confederations

[41] Dinheiro Vivo (2012) *Ministro da Economia: Governo tudo fará para dinamizar contratação coletiva*, 17 July: https://www.dinheirovivo.pt/economia/ministro-da-economia-governo-tudo-fara-para-dinamizar-contratacao-coletiva-12612020.html
[42] Council of Ministers Resolution 90/2012.

(CAP, CIP, CCP, and CTP) sent a letter to the IMF's mission chief in Portugal, claiming that extensions were fundamental to the functioning of the Portuguese economy.[43] However, the resolution entered into force at the end of the month, which led to the effective implementation of the new criteria.

As for the additional reduction in dismissal costs, the negotiations between the Troika and the government revolved about adopting a value that would best reflect the EU average. The second program review concluded in late 2011 (before the signing of the Tripartite Agreement), had already quantified the figure as any value between 8 and 12 days (International Monetary Fund 2011c, 101). However, UGT vehemently criticized the proposal – disputing that the EU average was equal to 12 days – and warned the government about the negative social consequences of pushing ahead with the planned changes.[44] But the government pushed forward with legislation at the end of 2012 to bring the average down to 12 days. At the same time, the government negotiated with the Troika some alterations to the proposal to soften UGT's potential resistance. The compromise reached between the lenders and the Portuguese executive reflected the following changes: a) regarding open-ended contracts, severance pay would be cut to 12 days for collective dismissals, while in the case of individual dismissals, compensation would be reduced from 20 to 18 days for the first three years of the contract, and to 12 days in the subsequent years; b) a similar framework was approved for fixed-term and temporary contracts; c) rights acquired up to the date of

[43] Dinheiro Vivo (2012) *Novos critérios para publicação de portarias de extensão entram em vigor esta quinta-feira*, 31 October: https://www.dinheirovivo.pt/economia/novos-criterios-para-publicacao-de-portarias-de-extensao-entram-em-vigor-esta-quinta-feira-12620287.html
[44] Diario de Noticias (2013) *Se proposta não for revista, UGT tirará daí consequências graves*, 2 January: https://www.dn.pt/economia/dinheiro-vivo/se-proposta-nao-for-revista-ugt-tirara-dai-consequencias-graves-2973044.html

the new law would be preserved.[45] The latter had been one of UGT's main demands in its discussions with the government (interview 1209).

Therefore, while the government was concerned about the potential negative consequences of bringing down dismissal costs to a level beyond what was acceptable to trade unions, it still believed it was important to implement a significant reduction. As explained by a member of the government in an interview:

> "The initial MoU was not very precise (regarding the level of dismissal costs to be reached). The idea was to bring labor standards close to European ones. We thought that if we wanted the economy to get going again, it was important to reduce the value significantly, even if the trade unions had a different opinion" (interview 1208).

The government justified this measure because it was part of the loan terms. Already in late 2011, Assistant Secretary of State to the Prime Minister Carlos Moedas, who was in charge of coordinating the implementation of the bailout, declared in a parliamentary hearing that bringing dismissal costs down to a number between 8 and 12 days "was already in the original version of the memorandum."[46] Once the government approved the measure, Prime Minister Passos Coelho stated that "we had committed in the memorandum of understanding to set dismissal costs (at a value) between 8 and 12 days."[47] Shortly after, the PS filed a no-confidence motion against the government. During the debate on the motion, Passos Coelho spoke in general terms about the importance of complying with the MoU given the high cost attached to forgoing external assistance, using the government's unattractive BATNA to justify the reforms imposed under the program:

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[45] Law 99/2013.

[46] Diario de Noticias (2011) *Carlos Moedas: Indemnizações por despedimento de 8 a 12 dias já estava no memorando*, 20 December: https://www.dn.pt/economia/carlos-moedas-indemnizacoes-por-despedimento-de-8-a-12-dias-ja-estava-no-memorando-2196599.html (translated from the Portuguese).

[47] RTP Noticias (2012) *Passos dá aval a indemnizações a 12 dias para despedimentos*, 12 December: https://www.rtp.pt/noticias/economia/passos-da-aval-a-indemnizacoes-a-12-dias-para-despedimentos_n611087 (translated from the Portuguese).

> “Without overcoming the national emergency, that is, without fulfilling the essentials of the Economic and Financial Assistance Program, there is not enough confidence to regain our autonomy nor is there access to financing. Without confidence, without autonomy, and without financing, there will be nothing but very limited freedom and certainly a perpetuation of social and economic pain, with deepening unemployment and social injustices.”[48]

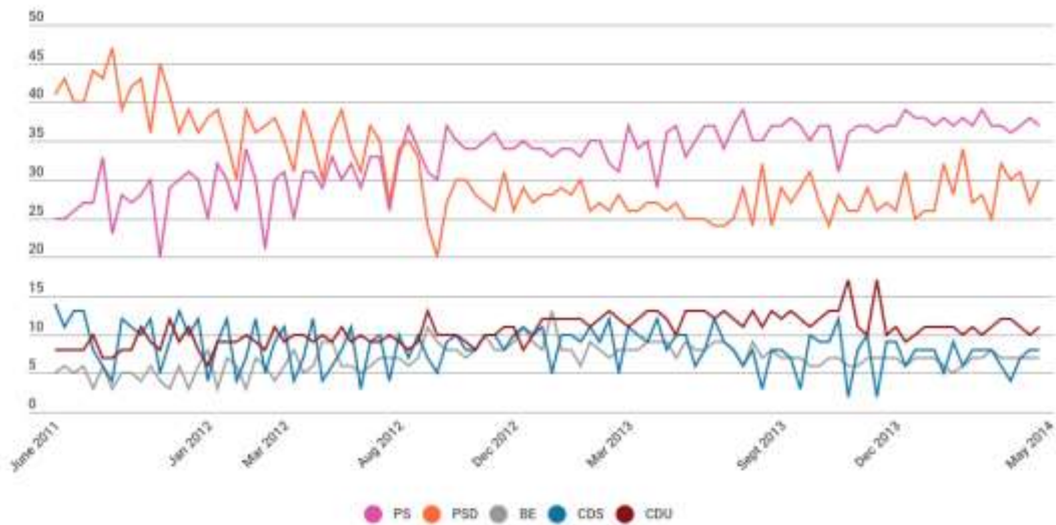
3.4.4 Second phase of labor policy under conditionality (mid-2013 – mid-2014)

In its seventh quarterly review that followed the implementation of the policy changes, the IMF acknowledged that the approved measures would bring severance costs significantly closer to the EU average (International Monetary Fund 2013, 21). However, the combined eighth and ninth reviews pointed out that the reform had created a gap between the costs of fair and unfair dismissals and that policy options to address the latter would have to be discussed between the Portuguese government and the Troika (International Monetary Fund 2013c, 21).

In reality, the government was reluctant to implement further changes to labor rules that it thought would only undermine social consensus, and it made its views known during the meetings with the Troika (Santos Pereira 2014, 108). For instance, the Fund suggested that the government should reduce the minimum wage for certain categories of workers to increase hiring. However, Santos Pereira did not think the measure was socially fair and doubted it would have the desired effect (ibid.). Other members of the government also believed it would be very problematic from a domestic political standpoint (interview 1408). Moreover, both ruling parties had lost significant support in opinion polls, with the PSD starting to fall behind the opposition PS from the second half of 2012 onwards.

[48] PSD (2013) *Discurso do Primeiro-Ministro no debate da Moção de Censura, no Parlamento*, 3 April: https://www.psd.pt/pt/noticias/discurso-do-primeiro-ministro-no-debate-da-mocao-de-censura-no-parlamento

Figure 3.1: Poll averages for the main Portuguese political parties



Source: popstar.pt based on opinion polls by Eurosondagem, Universidade Catolica Portuguesa, Marktest and Aximage

At the same time, the ruling parties were becoming increasingly at odds over the implementation of the EAP, with the government undergoing a crisis and subsequent reshuffle in July 2013.[49] To make things more complicated for the ruling coalition, the UGT joined CGTP in a general strike in November 2013 against the executive's fiscal policies, effectively putting an end to UGT's decision to avoid participating in large demonstrations against the government. Moreover, the Constitutional Court invalidated several aspects of the reform of the definition of fair dismissals in September through its ruling 612/2013. The court's veto meant that the Portuguese executive had to agree to explore options to deliver alternative measures that would deliver a similar effect to the annulled reforms (European Commission 2013b, 29).

[49] BBC (2013) *Portugal head backs government and rejects snap poll*, 21 July: https://www.bbc.co.uk/news/world-europe-23400981

The cabinet shake-up that took place in July led CDS leader Paulo Portas to become Deputy Prime Minister, with direct responsibility for negotiations with the Troika. Meanwhile, Pedro Mota Soares, a PSD career politician, replaced Santos Pereira as labor minister. The choice of Mota Soares PS signaled the party leadership's willingness to name someone who would generate less animosity vis-à-vis the social partners. To tackle the challenge posed by the court's ruling, the new holder of the labor portfolio proposed new criteria for the extinction of the labor relationship and discussed them with social partners in the hope of getting their support. However, both the trade unions and the main employers' confederation (CIP) opposed the proposed changes. The government ended up proposing five new criteria for choosing redundant employees performing similar tasks in a firm: 1) a worse performance appraisal, 2) lowest educational and professional qualifications, 3) highest cost of maintaining a worker in the company, 4) seniority in the task and 5) seniority in the company.[50] It ultimately dropped a sixth criterion (the economic and family situation of the worker) that had elicited the particular resistance of social partners.[51] Although the Troika accepted the proposed changes, it stated that "a preferable solution would have been a global assessment based on the full set of criteria, but this was considered to be subject to constitutional risk" (European Commission, 2014a, p. 39).

In parallel, the international lenders continued to push for further labor reforms. Two members of the government suggested in interviews that the IMF was especially adamant in pushing for measures that would lead to a deeper liberalization labor market (interviews 1204 and 1208). In other interviews, members of the Troika confirmed that the EC and the ECB had taken a more relaxed approach when it came

[50] Law 27/2014.
[51] Jornal de Negócios (2014) *Governo aprova cinco critérios para justificar despedimentos*, 13 February: https://www.jornaldenegocios.pt/economia/emprego/lei-laboral/detalhe/governo_aprova_novos_criterios_de_despedimento

to labor reforms, believing the government had already done enough (interviews 1302, 1303).

Regarding specifically employment protection levels, the Fund wanted the government to approve a decrease in the cost of unfair dismissals (International Monetary Fund, 2014, p. 15). The Commission also mentioned the issue in its eleventh quarterly review, stating that: "the current large gap between compensation for fair and unfair dismissals may create perverse incentives for fair dismissals to be challenged in court leading to uncertainty of a dismissal." It also suggested that reform proposals on the matter would be discussed during the program's last review (European Commission, 2014a, p. 39).

In December 2013, the Troika met with the social partners to discuss further reforms to the country's labor market.[52] However, the lenders' efforts to persuade the trade unions about the need to reduce dismissal compensation for unfair dismissals were rather unsuccessful, with union leaders staunchly rejecting any additional policy changes (interview 1303). The more intense resistance by trade unions suggests domestic constraints to reforms were becoming significantly stronger for the government. In fact, the government refused to adopt new policy changes to cut severance fair for unfair dismissals. Mota Soares strongly rejected the measure in his discussions with the Troika on the basis that it would unsettle the relationship with social partners and disrupt social peace (Reis Pires 2015, 120), which suggests a tied hands rhetoric vis-à-vis the international lenders.[53] In one of the interviews, a

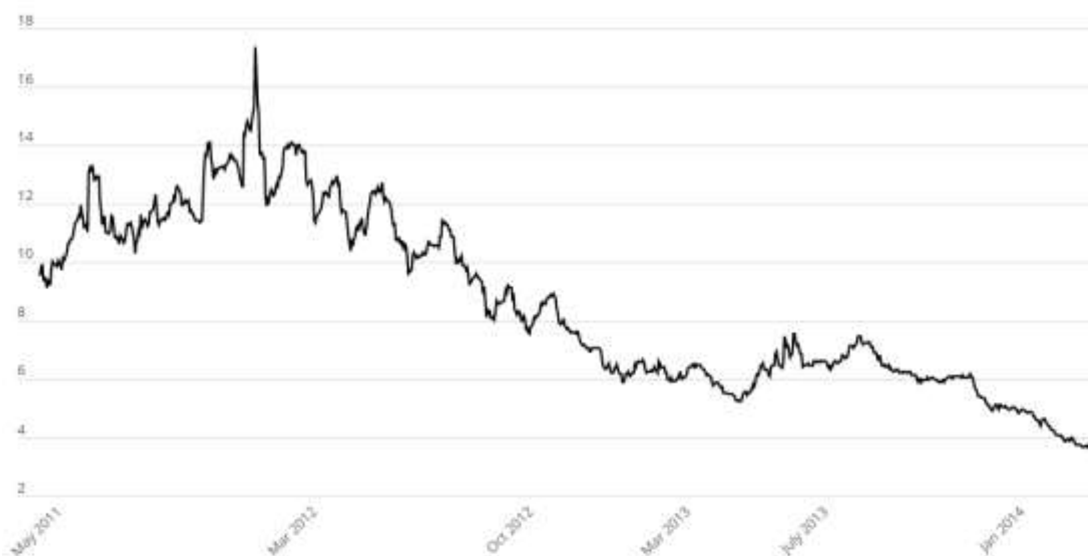
[52] Jornal de Negócios (2013) *Governo convoca parceiros sociais para reunião com a troika no dia 11*, 3 December: https://www.jornaldenegocios.pt/economia/detalhe/governo_convoca_parceiros_sociais_para_reuniao_com_a_troika_no_dia_11

[53] See also Jornal de Negócios (2014) *Governo afasta descida das indemnizações por despedimento ilegal*, 28 April: https://www.publico.pt/2014/04/28/economia/noticia/governo-afasta-descida-das-indemnizacoes-por-despedimento-legal-1633814

Portuguese policymaker confirmed the government believed it had already done enough regarding the labor market and that it was not willing to go as far as the Fund requested (interview 1205).

Moreover, the country's financing prospects had started to improve, especially after the ECB's announcement about the creation of its Outright Monetary Transactions program in the fall of 2012, which allowed the Portuguese debt management agency to sell 10-year bonds in May 2013. While the political crisis of July 2013 had brought funding costs up for a brief period, they continued to decrease towards the end of the year, as shown by the following graph:

Figure 3.2: Portuguese 10-year bond yields



Source: Bloomberg

The Troika sensed that once the prospects of accessing private sovereign financing had improved, the Portuguese executive felt emboldened to push back against the Troika's demands for further reforms (interview 1403). Another member of the Troika evoked how difficult it became for the lenders to convince the

government to adopt additional reforms as elections approached and the government regained access to sovereign debt markets:

> "More could have done more regarding the labor market. However, elections were getting closer, and as a result, the will of the government to do things went down. Eventually, all domestic actors came together pushing against additional reforms. Moreover, once the access to sovereign debt markets was restored, the fear factor was gone. It became very difficult to get things done" (Interview 1303).

With elections due in the fall of 2015, key members of the cabinet started indeed to signal to voters that they were eager to get rid of the MoU. For instance, at a CDS-PP party event that took place in January 2014, Deputy Prime Minister Pedro Portas unveiled a clock that counted the time left until Portugal would exit its EAP. In his speech, Portas stated that program exit would entail "the end of the protectorate" and that the country would recover its "freedom and autonomy as a nation."[54]

In the end and following discussions with the Troika during the first quarter of 2014, the government announced that dismissal costs for unfair dismissals would be left untouched. When explaining the rationale for such a decision, Labor Minister Mota Soares explained that further reducing dismissal costs would "send the wrong signal to social partners and to the wider society."[55] Such a message suggests that the government was keen on avoiding further labor reforms that could generate social unrest and hurt the ruling parties politically.

[54] Jornal de Negócios (2014) *Relógio de Portas para a saída da troika está errado*, 7 January: https://www.jornaldenegocios.pt/economia/ajuda-externa/detalhe/relogio_de_portas_para_a_saida_da_troika_esta_errado

[55] Jornal de Negócios (2014) *Governo recua na redução de indemnizações por despedimento ilegal*, 28 April: https://www.jornaldenegocios.pt/economia/emprego/lei-laboral/detalhe/governo_recua_na_reducao_de_indemnizacoes_por_despedimento_ilegal

3.5 Discussion

Overall, the evidence provided in the cross-time case study validates the hypotheses regarding the use of external constraints to promote domestic economic reforms, although with some qualifications. The government introduced reforms it favored in the MoU, which allowed it to push for its preferred policy changes, particularly in areas such as collective bargaining. These reforms were also justified very much on the basis that they were part of the country's international commitments, whose fulfillment was unavoidable given Portugal's lack of access to private sovereign financing. The government's willingness to "use the Troika" was stronger at the beginning of the program when it had just been granted a strong parliamentary majority, and there was a significant degree of consensus between the ruling parties.

At the same time, the fact that the government "used the Troika" does not mean its views were fully aligned with those of the lenders. It can be argued that, in certain situations, the Portuguese executive tried to balance its reform objectives with other considerations, such as trying to limit the potential resistance to reforms by trade unions. The reform of employment protection legislation is a case in point, with the government choosing the higher value of the EU average for dismissals costs and trying to negotiate a compromise with the Troika so the policy change would be more palatable to the unions. In other words, a reformist government might not necessarily share the full range of the lenders' reform postulates, as suggested elsewhere (Moury et al. 2021, 19).

When it comes to the use of domestic constraints vis-à-vis the Troika, the hypotheses seem to hold rather well. As the electoral outlook of the ruling parties started to deteriorate and the next legislative election started to look closer, the government used domestic constraints as a justification to avoid implementing further

reforms. This tactic became more prominent as the Portuguese sovereign regained access to debt markets, which emboldened the government to push back against the Troika's demands for additional policy changes.

As for the external validity of this paper's argument, some evidence suggests the dynamics highlighted in this paper might have been at play in other Eurozone countries where reform-minded executives implemented the MoUs. For instance, it is known that the Irish executive "invoked the Troika's force majeure" and used program conditionality strategically to carry out public service reforms (MacCarthaigh and Hardiman 2020). At the same time, strong domestic resistance to the introduction of water charges led the government to delay their introduction (and eventually cancel them) despite the Troika's demands, as acknowledged in one of the ex-post evaluations of the program (European Commission 2015a, 86). In the case of Cyprus, Lütz, Hilgers, and Schneider (2019b) claim that while the government used the high cost of no agreement at the beginning of the program to facilitate the enactment of reforms, it also obtained flexibility from the Troika when domestic constraints intensified (ibid. 1455). In any case, more research would be needed to determine, for instance, how important electoral considerations were in the two-level bargaining tactics of the Irish and Cypriot governments.

3.6 Conclusions

In this paper, I have drawn from Putnam's (1988) two-level game framework to clarify the factors that determine how borrower governments behave strategically under conditionality. I have shown reform-minded executives tie their hands vis-à-vis domestic constraints to implement policy changes when the cost of no agreement is elevated, and they face a low risk of being replaced in elections. However, when electoral risks increase for the government and the perceived cost of forgoing financial

assistance declines, domestic constraints translate into hand tying vis-à-vis the international lenders. To be clear, this did not mean that the governments necessarily welcomed the reduced autonomy that came attached to economic conditionality. Rather, the paper shows that governments try to make the best out of existing constraints on both the international and the domestic levels, much as Putnam enunciated.

To my knowledge, the paper is the first study to reconcile two of the main predictions made by the conditionality literature regarding the strategic behavior of borrower governments. Its main theoretical contribution is to highlight the importance of electoral incentives and bargaining power in the strategic calculations of executives under conditionality. A central consideration of the literature on political parties is that politicians are motivated to both achieve policy goals and hold office (Meyer and Wagner 2014; Müller and Strøm 1999; Pedersen 2012). Therefore, even in highly constrained contexts, politicians are likely to take into consideration how the policies they make might affect their re-election chances. In the context of crisis lending, this implies considering how to use conditionality best to achieve such a goal. Moreover, the paper answers recent calls for studies to explore the validity of the "Schelling paradox" (Schelling 1960) more systematically, that is, to specify the conditions under which governments are willing to exploit domestic constraints to obtain an advantage in international negotiations (da Conceição-Heldt and Mello 2018).

Moreover, the scholarship on two-level conditionality negotiations has analyzed the importance of BATNA in determining a borrower government's choice of a hard bargaining tactic towards Level I (Zahariadis 2017) and Level II (Lütz, Hilgers, and Schneider 2019b) separately. However, the paper also shows that the cost of no agreement is an important factor influencing the ability and willingness of a

borrower government to behave strategically under conditionality towards *both* international and domestic actors in two-level game negotiations.

In terms of the study's limitations, the scope conditions of the advanced explanation limit its applicability to certain cases. The application of the proposed framework is restricted to reform-minded executives, as it is unlikely that a government that opposes the type of reforms postulated by crisis lending conditionality will use it strategically at home. Nevertheless, in his account of his time as finance minister of Greece during the early stages of the crisis, George Papaconstantinou states that when it came to the implementation of certain structural reforms, he was "delighted that (he) had an ally in the Troika" (Papaconstantinou 2016, 129). Further research could explore to what extent the factors suggested in this paper shape the ability of reformist ministers to push for reforms within governments that are skeptical of the type of policy changes advanced by structural conditionality.[56]

The Covid-19 pandemic has forced a rethinking of EU crisis management tools, including the creation of a temporary Recovery and Resilience Facility requiring countries to propose national reform plans – assessed by the Commission – to receive funds. Future studies could explore to what extent the transition towards softer forms of conditionality creates the conditions for governments to exploit both external and domestic constraints strategically.

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[56] For instance, Moury et al. (2021) correctly argue that reformist ministers across all bailed-out countries did use conditionality to advance their agendas.

4 – *Selling the Family Silver under Pressure: Privatization in Greece during the Eurozone Crisis*

Abstract

When does conditionality lead to the implementation of reforms by recalcitrant borrower governments? Greece was a most likely case of limited privatization under external conditionality during the Eurozone crisis, given the country's limited reform capacity. However, while the country struggled to privatize assets during its first Economic Adjustment Program (EAP), asset sales gained pace during the second bailout, only to accelerate significantly during the third program. Combining Putnam's (1998) two-level framework and EU conditionality theories, I explain this puzzle by arguing that international lenders sometimes deploy coercive strategies to widen the borrower governments' win-set by making conditionality more determinate and its link with funding tighter. However, such a strategy is only effective when the borrower government perceives that the creditors are willing to carry out the threat of withdrawing financial assistance. Contrary to existing studies, the paper shows that coercive threats translate into reform implementation under conditionality when politicians' discretion over the enforcement of policy prescriptions by the relevant bureaucratic units is low. The findings have important normative implications regarding the democratic viability of conditionality as it was applied during the Eurozone crisis.

4.1 Introduction

European integration has generally been considered a major stimulus for the redrawing of the boundaries between states and markets through the privatization of state assets (Clifton, Comín, and Fuentes 2006; Dimas 2010; Pagoulatos 2005; Thatcher 2004). This external influence became stronger during the Eurozone crisis for the member states that had to apply for financial assistance, as privatization was a centerpiece of the bailout conditionality agreed with the international lenders. According to the literature, the impact of the loan terms on asset sales should have been mediated by domestic factors, with left-wing borrower governments and executives facing numerous veto players trying to reduce the amount of privatization under conditionality (Breen and Doyle 2013; Doyle 2012). In this regard, Greece can be considered a most likely case of limited privatization under conditionality, given the well-known myriad domestic constraints on asset sales the government faced before the crisis (Featherstone and Papadimitriou 2008; Pagoulatos 2001; Trantidis 2016a). Still, while the country struggled to privatize assets during the first program, asset sales gained pace during the second bailout and significantly accelerated during the third program.

This paper adds to existing accounts that claim that creditors' threats to withdraw financial assistance led to a higher level of reform implementation under conditionality (Hennessy 2017). Combining Putnam's (1998) two-level framework and EU conditionality theories, I posit that international lenders sometimes deploy coercive strategies to widen a borrower government's win-set by making conditionality more determinate and its link with funding tighter. The study also shows that coercive threats translate into reform implementation when politicians' discretion over the enforcement of conditionality is reduced, contrary to existing explanations.

To show the relevance of the proposed argument, I conduct a cross-time case study of privatization in Greece under its three Economic Adjustment Programs or EAPs (2010-2012, 2012-2014, and 2015-2018). The study draws on the analysis of interviews with Greek, EU, and IMF policy elites involved in key decisions regarding privatizations during the three bailouts. I also examine official documents such as the quarterly reviews from the monitoring institutions, ex-post evaluations of the programs by different organizations, national policy documents, press content, and first-hand accounts.

The paper is structured as follows. I first review the extant literature on the impact of external influences on privatization policy and explain why Greece can be considered a most likely case of limited privatization under conditionality. I then proceed to outline an alternative explanation that takes into consideration the two-level nature of EAPs. The third section covers the case study, while the last section discusses the paper's insights and provides the conclusions.

4.2 Privatization under external pressure

European integration has generally been perceived as an important driver of privatization in EU countries, whether because of the constraints exercised by EU legislation (Clifton, Comín, and Fuentes 2006) or due to the opportunity the latter provides to sympathetic governments to justify privatization vis-à-vis public sector employees and trade unions (Thatcher 2004).[57] Eurozone bailouts entailed an upgrade of the external stimulus in favor of divestiture. The EAPs designed during the Eurozone crisis largely adopted the template of IFI's structural adjustment programs

[57] See also Dimas (2010).

(Greer 2014), which are known to lead to higher degrees of divestment from public assets (Brune, Garrett, and Kogut 2004; Henisz, Zelner, and Guillen 2005).

Still, Breen and Doyle (2013) show the volume of privatization under IMF conditionality is shaped by domestic political factors. For instance, left-leaning governments are associated with lower levels of privatization, a relationship previously underlined by (Doyle 2012) in Latin American countries under IMF loans.[58] Moreover, borrower governments struggling to overcome domestic veto players and executives facing elections tend to be more unwilling to sell public assets, given the potential electoral costs (Breen and Doyle 2013, 17).

From this standpoint, Greece represents a most likely case of limited privatization under external conditionality. Broadly speaking, the country has been considered one of the most problematic cases of EU-induced privatization given its limited reform capacity, with EU pressure to restructure public companies frequently clashing with domestic political realities (Featherstone and Papadimitriou 2008). More specifically, two factors should have made privatization under conditionality particularly difficult. First, Greece had one of the highest degrees of party patronage in Europe before the crisis (Kopecký et al. 2016), which makes governments especially reluctant to introduce reforms that reduce their ability to use the spoils from the public sector for electoral gains (Afonso, Zartaloudis, and Papadopoulos 2014). In Greece, such a dynamic was in place in the years leading up to the crisis, with clientelistic links between parties and public sector unions acting as a powerful constraint on privatization processes before the Eurozone crisis (Trantidis 2016b, 2016a).

[58] This claim connects with a well-established argument about the importance of partisanship in the literature about privatization (Bjørnskov and Potrafke 2011; Boix 1997; Bortolotti, Fantini, and Siniscalco 2004; Doyle 2010; Zohlnhöfer, Obinger, and Wolf 2008).

Second, Greece was known before the crisis for having a public administration captured by political parties and an underperforming central bureaucracy (Dimitrakopolous and Passas 2020, 27). Moreover, research shows that intra-cabinet conflicts over privatization sometimes undermined previous plans to sell assets (Pagoulatos 2001). The fact that the state tended to keep direct control of privatized public companies or maintained indirect channels of influence (Pagoulatos 2005) is also a testament to the Greek elites' resistance to letting go of public enterprises. In sum, we would expect conditionality to have a limited impact on the level of divestiture in Greece. However, this is not the picture that emerges when looking at privatization outcomes under the country's three bailouts.

The first EAP in Greece (2010-2012) exposed the traditional difficulties of selling public assets in Greece, even though the center-left PASOK government implemented institutional reforms and initiated some sales. Privatization gained pace during the second EAP (2012-2015) under the ND-PASOK-DIMAR broad coalition, although the international lenders considered the progress insufficient (International Monetary Fund 2017, 49). However, asset sales considerably accelerated under the third program (2015-2018), implemented by a government headed by the radical-left SYRIZA party and supported by the far-right ANEL. While 14 transactions were executed between 2011 and 2014, as many as 27 were completed during 2015 and 2018[59]. Specifically, major projects were completed during the third program under the SYRIZA-ANEL administration, such as the sale of 51% of the Piraeus port to Chinese port operator COSCO Shipping or the sale of 100% of rail company TRAINOSE to Ferrovie dello Stato Italiane Group (FSI). Therefore, not only did

[59] See Annex 2 of this dissertation.

Greece not conform to existing theoretical expectations, but there was a significant change in terms of privatization outputs during the three programs.

The literature on Eurozone bailouts has explored two different aspects that might be relevant to explaining potential variations in the implementation of reforms under conditionality. The first one is program design. For instance, Genovese and Hermida-Rivera (2022) claim the Troika allowed the executives' partisan preferences to influence the crafting of conditions. In contrast, scholars using bargaining theory to explain negotiation outcomes during the Eurozone crisis have tended to converge on the low negotiation power of executives as a key explanatory factor behind the design of MoUs. Bargaining power is determined by the availability of outside options – also known as the best alternative to a negotiated outcome (BATNA) – beyond cooperation (Dür and Mateo 2010b; J. S. Odell 2003; Stone 2011; Zahariadis 2017). In other words, the more an actor needs an agreement, the less bargaining power it enjoys (Keohane and Nye 1977). Given that borrower governments normally have more to lose for non-cooperation than the party providing financial assistance, Eurozone bailed-out countries were in a particularly weak position vis-à-vis their creditors in negotiations (Frieden 2015; Frieden and Walter 2019; Moschella 2017; Schimmelfennig 2015).

Looking at the specific case of Greece, Lim, Moutselos, and McKenna (2019) suggest that the outcome of conditionality negotiations in the three programs was indeed unsurprising. They claim that Greece always had more to lose from non-cooperation, even if creditors were willing to provide the country with some concessions because of its economic weakness. In a similar vein, Tsebelis (2016) looks at the negotiations around the third program and concludes that, in addition to the constraint provided by unanimity in Eurozone decision-making, Greece's lack of liquidity forced the SYRIZA government to cave into most of the lenders' demands.

Panke (2019, 60) advances a similar argument, claiming that the Greek government was "entrapped" by its commitment to "avoid bankruptcy and sovereign default on the one hand, and stay in the Eurozone on the other." In sum, the less bargaining power the Greek government had, the less it could influence the design of conditionality.

The second relevant aspect is the implementation of the loan terms. Hennessy (2017) suggests creditors can promote higher levels of program implementation if they can credibly signal they are willing to withhold financial assistance despite the potentially high costs of such a decision for them. In the case of Greece, this argument assumes that the change in political incentives caused by costly signaling during international negotiations suffice to trigger higher levels of program implementation by the borrower government, given that Greek politicians enjoy a high degree of discretion to sanction non-compliant bureaucrats (ibid, 747).

While insightful, these studies provide an incomplete picture of program implementation for two reasons. The first issue is that these works do not address the problem of defection that tends to affect international cooperation. A borrower government that is forced to accept an unfavorable agreement during the initial negotiations of the program might still want to limit its associated costs by resorting to strategies such as foot-dragging or exploiting the ambiguity of the deal's terms during its implementation (Abbott et al. 2000; Börzel 2002; Chayes and Chayes 1995). The second problem is that they focus primarily on the negotiations that happen at the outset of each program, which provides for a static analysis of program negotiations and implementation. Instead, IFI conditionality is the result of an iterated process of interaction between international lenders such as the IMF and the borrower government (Mussa and Stavano 1999), with policy conditions subject to a "stream of negotiations dotted with waivers, breakdowns and renegotiations" (Kahler 1993, 364).

These repeated interactions are affected by the political and economic developments that occur during the program's implementation. Therefore, by focusing exclusively on discrete negotiation episodes, we might be missing crucial information about how conditionality is shaped by the bargaining that happens during the course of the whole program, which is necessarily influenced by the degree of compliance with the loan terms by the borrower government.

4.3 The argument

To better capture how the iterated interactions between the international lenders and a borrower government shape the negotiations around the loan terms and their implementation, I draw from the two-level game (TLG) concept developed by Putnam (1988). My core claim is that international lenders react to domestic developments in the borrower country regarding program implementation and reshape conditionality with the goal of promoting compliance. Reform-skeptic borrower governments, in turn, implement more policy changes the stricter and the more credible conditionality becomes.

According to the TLG framework, Chief of Governments (COGs) negotiate concurrently on two levels, the international (Level I) and the domestic (Level II). Cooperation is only possible when the range of potential outcomes that can be ratified by each domestic constituency (the win-set) are compatible. On Level II, the preferences and coalitions of domestic actors, as well as the existing ratification procedures, determine the size of the negotiator’s win-set. In the case of IMF-style programs, “ratification” of the deal by the borrower government can be understood as the implementation of the bailout terms agreed with the international lenders. Therefore, the win-set is determined by the actors (e.g., government members,

parliament, bureaucracy, and interest groups) and the approval and implementation procedures relevant to the policy area targeted by conditionality.

When the win-sets of both sides do not coincide, Level I negotiators can deploy strategies to restructure the other side's payoffs and widen its win-set by altering "one another's perceptions of the costs of no-agreement and the benefits of proposed agreements" (Putnam 1988, 458). These strategies include the use of coercive threats, side payments, and attempts to alter the preferences of the constituents of the other side through suasive "reverberation." However, the use of persuasion tends to be challenging in the contexts of structural adjustment programs with significant distributional consequences, and IMF-style loans often elicit domestic nationalist responses, i.e., "negative reverberation" (Kahler 1993, 360).

Lending organizations such as the IMF normally have limited tools to expand the win-set of borrower governments and prevent defection from the loan terms besides refusing to provide funding in the event of non-compliance, essentially a coercive strategy (Khan and Sharma 2001; Mussa and Stavano 1999; Reinsberg et al. 2019; Vreeland 2006). Nevertheless, the Fund can "insert" this coercive threat into conditionality by using prior actions, which are commitments a government must meet for a review to be completed and a loan installment to be released (International Monetary Fund 2019; Rogers 2012, 9; Woods 2006, 70–71). In fact, the Fund is known to use more prior actions to promote domestic policy change in cases of countries with poor implementation track records (Thomas and Ramakrishnan 2006, 9). The EU has also been shown to promote compliance with conditionality by making it more precise, which signals the saliency of the required policy change to the other side (Schimmelfennig and Sedelmeier 2020).

At the same time, asymmetric information means that lending organizations are not always able to anticipate the domestic constraints to the implementation of conditionality at the outset of a program and thus design conditionality accordingly (Mayer and Mourmouras 2005; S. Nelson 2014; Reinsberg, Stubbs, and Kentikelenis 2021). International lenders such as the IMF usually revise program conditionality because of the information they obtain through their monitoring activities, which entail a "continuous assessment by the staff of developments in the borrowing country and of their implications for the attainment of the main goals of the program" (Mussa and Stavano 1999, 13). Put differently, in the context of iterated interactions, the main actors in the process react to new information and update their behavior accordingly (Heclo 1974).

Therefore, we can expect international lenders to deploy strategies to widen the win-set of the borrower government in a specific policy area and prevent defection from the loan terms only when they can acquire enough information about its willingness and ability to implement them. Hence the first hypothesis (applied to privatization conditionality):

H1. International lenders will make privatization conditionality more determinate, and its link to funding stronger, the higher the perceived domestic opposition to privatization.

The observable implications of this hypothesis would be evidence from program documents acknowledging any obstacles to the implementation of asset sales, as well as statements from EU and IMF personnel linking the hardening of conditionality (both in terms of its rewards and precision) to concerns about program compliance by the Greek government.

To determine whether and when lenders' coercive strategies on Level I reshape incentives on the borrower government's Level II, I draw from the external incentives model (EIM) of conditionality developed by Schimmelfennig and Sedelmeier (2004). The model has been used to study public sector reforms in Greece during the bailout period (Dimitrakopolous and Passas 2020; Featherstone 2015), but it has still not been applied to the analysis of economic policy changes under conditionality. The EIM predicts that a government implements policy conditions when the benefits of doing so exceed the expected domestic costs. High determinacy of the conditions and a strong link between their implementation and the reward provided are seen as two necessary conditions for governments to implement conditionality. However, the EU's threat to withhold the prize attached to the implementation of the prescriptions also needs to be credible enough for such an equilibrium to materialize (Schimmelfennig and Sedelmeier 2020, 817). For conditionality to be credible, "the EU must be able to withhold the rewards at no or low costs to itself." In cases of crisis lending, such a strategy is not realistic if it leads to negative externalities that affect creditors, such as financial contagion (Chapman et al. 2017). Such was the situation at the outset of the Eurozone crisis, when international lenders' main worry was to avoid a Greek default that could jeopardize the stability of the common currency area (Henning 2017, 205; Schimmelfennig 2015, 181).

Translated into two-level game terms, a threat such as withholding funding is designed to increase the cost of no agreement for the other side (Moravcsik 1993, 29). However, coercive threats in crisis lending do not work if the borrower government expects creditors' concerns about negative externalities to widen the win-set of the international lenders, making non-compliance more likely. Conversely, if the borrower government perceives during negotiations that the win-set of the international lenders

is narrow enough for the coercive threat to be credible, then it is more likely to proceed with the implementation of the policy changes included in the loan terms. The addition of the credibility dimension to those of precision and the rewards attached to conditionality gives us our three hypotheses on the implementation of conditionality:

H2. A borrower government facing resistance to asset sales will implement more privatizations under conditionality the higher the perceived credibility of creditors' threats.

H3. A borrower government facing resistance to asset sales will implement more privatizations under conditionality the stronger the link between conditionality and funding.

H4. A borrower government facing resistance to asset sales will implement more privatizations under conditionality the higher the number of conditions and their precision.

The dependent variable in the second hypothesis is the effective implementation of privatizations and not the receipts obtained, which can be influenced by factors outside of the government's control, such as macroeconomic conditions. The observable implications we would expect to see are evidence of Greek policymakers pushing more strongly for asset sales as a result of the hardening of conditionality. To validate the proposed explanation, the next section makes a cross-time comparison of the implementation of privatization conditionality during Greece's three EAPs between 2010 and 2018.

4.4 Privatization under conditionality in Greece

4.4.1 Background

The first privatizations in Greece took place in the 1990s against a background of strong state intervention in the economy, with investment by State-Owned Enterprises (SOEs) accounting for more than 25% of gross fixed capital formation in 1985 (Lioukas and Papoulias 1990, 171). In 1990, there were 52 public enterprises directly controlled by the government, and state-controlled banks and the Industrial Reconstruction Organization directly owned or controlled 152 firms (Wright and Pagoulatos 2001, 139). As a result, Greek governments in the 1990s had to implement nothing short of a "paradigm change" to privatize state assets mainly as a way to meet the demands stemming from globalization and EU membership, specifically the requirement to meet the deficit and debt targets set by the Maastricht Treaty (Clifton, Comín, and Fuentes 2006; Pagoulatos 2005). Successive ND and PASOK executives implemented divestment programs targeting a wide range of assets, including banks, telecommunication firms, and manufacturing companies. Half of all privatizations were implemented as private sales and the other half as public offerings. Overall, Greece obtained around EUR 31bn in privatization revenues in the twenty years preceding the Eurozone crisis (Skreta 2017).

At the same time, the sale of state assets during these years can be largely characterized as incremental, with the state implementing partial privatizations and retaining control of the companies or remaining indirectly involved in them (ibid. 263, Pagoulatos 2005). This process was accompanied by the adoption of corporate governance and market rules. Still, no major changes were made to the government institutions in charge of privatization beyond the rebranding and reorganization of existing structures (Lampropoulou 2021).

4.4.2 First Economic Adjustment Program (2010-2012)

Greece's 2008 Stability and Growth Program, drafted by the ND administration of PM Kostas Karamanlis, espoused the continuation of the hitherto incremental approach to privatization (Sarımehmet Duman 2021). However, the victory of George Papandreou's PASOK in the early election of 2009 led to the disclosure of the dire state of the country's public finances, which triggered a reformulation of privatization policy. In the second half of 2009, the Greek government worked with the European Commission to draft an update to the Stability and Growth Program submitted earlier in the year (interview 1407). The document, published in January 2010, included a plan for the "reduction or elimination of government control in most economic activities outside public goods, and the continued stake-holding in sectors of strategic importance for the public interest and national security" (Greek Ministry of Finance 2010b, 51). The expectation was that the government would privatize assets to the value of EUR 2.5bn in 2010. However, with Greece finding it increasingly hard to obtain funds in sovereign debt markets, the country decided to apply for financial assistance from its Eurozone counterparts and the IMF in April, with a program finally agreed on 3 May 2010.

The initial wording of the MoU established that the government would have to "prepare a privatization plan for the divestment of state assets and enterprises to raise at least 1 billion euro a year during the period 2011-2013" as a structural benchmark for end-December 2010 (European Commission 2010c, 66). Conditionality regarding the divestment of public assets was initially quite broad and thin. Greek decision-makers believed that the Troika's initial stance towards

privatization at the beginning of the program was rather relaxed, focusing on preparing an overall framework for asset sales (interview 1109).

Perceived domestic opposition to privatizations

The prospect of privatizing public assets engendered considerable resistance within PASOK, both from an ideological and organizational standpoint. For instance, senior members of the Greek government perceived there was substantial reluctance to privatize SOEs within the party, given public-sector union members formed the core of PASOK supporters (interview 1109). Some PASOK MPs also strongly opposed the divestment from assets such as those of the state gambling company Greek Organization of Football Prognostics S.A. (OPAP), allegedly because the organization was used as a source of patronage (ibid.). In addition, putting an end to the government's privatization plans was a frequent demand of the numerous anti-austerity protests during this period (Kanellopoulos and Kousis 2018). A specific example can be found in the General Federation of Employees of the Public Power Corporation (GENOP-PPC) actions, which launched rolling 48-hour strikes to protest the sale of a stake in the state-owned company.[60]

In addition to the strong political resistance to asset sales, the implementation of privatizations also faced bureaucratic obstacles. For instance, one of the program reviews stated that "the set-up where each ministry and a myriad of smaller entities manage and control government assets is less effective in extracting value from assets" (European Commission 2011c, 30). Another example is provided by the statement of a PASOK MP who was sympathetic to the sale of state assets and complained about the bureaucracy's inability to deliver on the privatization front, citing “conflicting

[60] Reuters (2011) *Greek power utility union to strike over stake sale*, 28 April: https://www.reuters.com/article/greece-ppc-strike-idUKLDE73R1HV20110428

regulations and far too many people involved in taking decisions on each single asset."[61]

The Troika started to become aware of the obstacles to asset sales as they started to monitor compliance with the program conditions. For instance, the first review stated that "privatisation plans have been rather vague so far, lacking a clear time planning" (European Commission 2010b, 47). In the interviews, members of the institutions acknowledged that they had initially "limited previous knowledge" about issues such as the weaknesses of the Greek bureaucracy and their negative impact on privatization policy (interview 1406). Another interviewee stated that the Troika learned during the course of the program that the government would "pass blanket laws regarding privatization actions but then refrain from enacting the necessary secondary legislation for their implementation" (interview 1304).

Evolution of conditionality

As the lenders became aware of the obstacles to asset sales, conditionality evolved from the mere requirement to publish a privatization plan toward much more specific commitments. In fact, asset sales started to become a more salient issue with each assessment of program compliance by the Troika, as shown by the fact that the term "privatization" in program documents became significantly more prominent from the third review onwards (European Parliament 2014, 20). The modified MoU in the fourth review stated that the government would have to sell assets to the value of EUR 390mn and adopt a privatization program to collect EUR 15bn by the end of 2012 and EUR 50bn by the end of 2015 (European Commission 2011b, 113). Moreover, the Greek government had to revise its goal for privatization revenues to EUR 7bn over

[61] BBC (2011) *Greeks worry about ambitious privatisation plans*, 5 October: https://www.bbc.com/news/business-15165030

three years, with the Troika mandating a revision of the existing privatization plan and actions to centralize the data on public assets (European Commission 2010e, 47). The third review saw a substantial increase in target revenues, with the government now aiming to collect EUR 50bn by 2015 (European Commission 2011d, 27).

The scope of conditions targeting privatization policy also widened. The initial MoU had a broad focus on identifying assets to be sold and preparing the concurrent privatization processes. Yet from the third review onwards, the Troika also included institutional reform as a condition, requiring the government to establish the abovementioned privatization agency – a "national wealth fund" – to manage the sales. Annex II of the revised MoU under the fourth review established very detailed guidelines on the governance structure of the new fund, including the right for the European Commission and the Eurogroup to appoint two observers to the Board of Directors. It also specified the mandate of the future agency and the requirement to transfer all privatizable assets to the fund (European Commission 2011b, 145). Following the creation of the agency and the transfer of an initial set of assets to the fund, the Troika pushed to "shift a second group of assets into the privatization fund covering transactions to be completed through end-2012" and "appoint legal, technical, and financial advisors for 14 projects to be completed by end-2012" (European Commission 2011a, 127).

The increased determinacy of the conditions was part of a wider trend affecting the program, with the lenders negotiating more detailed reform items across different policy areas. A member of the Troika suggested in one of the interviews that the institutions decided to increase the level of precision of the conditions in order "not to leave space for the divergent interpretation of conditionality by both sides" (interview 1405), with another suggesting it was a means to guarantee that "both sides

would have the same understanding of conditionality" (interview 1402). These statements suggest the Troika personnel started to make conditionality targeting privatization more precise to try to reduce the risk of defection by the Greek government.

In addition to the higher level of detail of conditions, the Troika also converted some of the required policy changes into prior actions to guarantee their implementation, such as the requirement to establish a privatization agency (European Commission 2011c, 106) or the obligation to prepare a privatization plan to sell assets through 2015 (International Monetary Fund 2011a, 90). The fifth and last review that took place before the program collapsed also included one prior action on privatization requiring the government to shift a group second set of assets into the privatization fund and appoint advisors for a number of sales projects.

Program outcomes

As predicted by the first hypothesis, privatization conditionality became progressively more precise. It was also increasingly linked more directly to the provision of financial assistance over time as international lenders became aware of the political and institutional obstacles to asset sales. However, the Greek government did not conduct any major sales beyond a 10% stake in OTE, the auctioning of radio frequencies, the sale of licenses for gaming, and the operation of gaming machines (Skreta 2017, 264). At the same time, the government did implement the institutional reforms required by the Troika by creating the Hellenic Republic Asset Development Fund (HRADF or TAIPED in Greek), which would subsequently manage all privatizations. All in all, the institutions found that the government had made very

limited progress on the privatization front compared with the initial goals of the program (International Monetary Fund 2013a, 17).

Several factors explain the low level of program implementation with regard to privatization. First, Greece’s bond yields significantly spiked following the Franco-German Deauville summit. This deterioration of market conditions led Greek policymakers to believe that the program was doomed to fail and that a second program would have to be negotiated (interview 1104), which reduced the incentive to push for asset sales. Most policy reforms dictated by the loan terms were indeed halted as the Troika and the government sat down to negotiate a new package in the second half of 2011.

Second, the signaling of the higher saliency of privatization via the higher determinacy of the policy conditions clashed with the Troika’s regarding sales targets. A key turning point was the steep increase in the goal of privatization receipts included in the third review. According to public accounts of the negotiations, the IMF suggested the abovementioned EUR 50bn figure, which was then assumed by the Troika (Blustein 2016, 195). The purpose of setting such a large sum in comparison with what was agreed hitherto was to generate confidence vis-à-vis financial markets regarding Greece's ability to repay its debts and gain time for the program to be implemented (interviews 1401, 1407, 1109).

While the figure was accepted by the Greek negotiators, it created additional substantial tensions within the cabinet and generated additional political resistance to asset sales (Papaconstantinou 2016, 184). Several members of the Greek government were indeed rather skeptical about the feasibility of the new target (interviews 1107, 1109, 1114), and a member of the Troika staff suggested in an interview that Greek

decision-makers “did not believe the numbers” (interview 1407). Therefore, by setting unrealistic expectations about privatization outcomes to generate external credibility vis-à-vis financial markets, conditionality became less credible in the eyes of those who had to implement it.

4.4.3 Second Economic Adjustment Program (2012-2014)

With all parties acknowledging that Greece would need additional funding, a new program was negotiated in October 2011. The agreement included a plan to restructure Greece's debt, known as the private sector involvement (PSI) exercise. However, Prime Minister George Papandreou decided to propose a referendum to obtain public support for the new bailout, which, in turn, led Eurozone leaders to suggest that the sixth tranche of the program would not be released unless the vote delivered a positive outcome (Bastasin 2012, 336). After backtracking on the organization of the plebiscite and under pressure from his own party, Papandreou resigned on 9 November. Former ECB Deputy Governor Lucas Papademos was appointed Prime Minister of a government supported by PASOK, ND, and the small left-wing Popular Orthodox Rally (LAOS).

The international lenders made the approval of the new program contingent on an extensive list of prior actions to be legislated by the end of February 2012, although none of them referred to privatizations. Following the adoption of all the necessary policy actions, a deal for a second EUR 130bn program was officially concluded. Papademos asked President Karolos Papoulias to dissolve parliament and call elections in late April. After the May election, failure to form a government led to a second poll in June that yielded a coalition government led by Antonis Samaras (ND) and joined by PASOK and the Democratic Left (DIMAR).

Perceived domestic opposition to privatizations

The domestic political costs of pushing ahead with privatizations were theoretically lower for the government during the second program, given the center-right ND party was leading the coalition. Key members of the government indicated they wanted to implement "pro-business" policies (interview 1110), with some believing privatizations would improve the efficiency of public enterprises and reduce public debt (interview 1106). However, the government still encountered significant political resistance to each privatization, both from certain ministries and from within the ruling parties. This opposition came even from ND MPs, with a member of the Greek government highlighting in an interview that "even some center-right politicians support a big state" (interview 1107).

In addition to the obstacles identified during the first program, the Troika learned during the course of the second program about the main challenges that were still affecting asset sales. As an example, in June 2014, the IMF complained about the delays in sales due to the "de facto lack of control of the privatization agency (HRADF) over some of its assets; gaps in its tools for the sale of minority stakes; hurdles to preparing real estate for sale (clearing land titles and granting permits); lengthy regulatory processes; the need for regulatory structures for network industries; and the need for sustained support from different ministries, which is often not assured," as well as many variables that lied "beyond the HRADF's competence," and offered "opportunities for resistance by vested interests" (International Monetary Fund 2014, 17).

The Troika felt the fund was not insulated enough from political pressures and that the government was not doing enough to push asset sales forward. For

instance, the fifth appraisal of the program by the IMF included a summary of the obstacles identified by a “privatization review” conducted by the HRADF and the Troika. Aside from different technical challenges, the review stated that “many of the actions needed to conclude sales are the responsibility of the Greek State. Examples include issuance of Ministerial Decisions, submission of legislation to parliament, and setting up well-functioning regulatory bodies for network industries. Delays in completing such actions have contributed to the slower-than-projected pace of asset sales” (International Monetary Fund 2014, 29).

The Troika’s perception of political interference with the HRADF was also compounded by developments in other areas that reduced the lenders’ trust in the ability of the government to deliver the required policy changes, such as the firing of the secretary-general for public revenues Harry Theoharis (interview 1304) (Dimitrakopolous and Passas 2020, 100). Moreover, the fund was subject to key personnel changes that further complicated privatization processes, with three CEOs resigning or being dismissed by the government between July 2012 and August 2013.

Evolution of conditionality

The EU and the IMF significantly tightened the link between the implementation of conditionality and the provision of financing during the second program by dividing some of the quarterly loan installments into “sub-tranches.” The latter would only be disbursed after verification by creditor institutions of compliance with a series of policy reforms called “milestones.” Specifically, during its second program, the Greek government had to implement seven different sets of milestones for a total of 24 policy actions and EUR 13.4bn of funding. However, privatization policy was not particularly targeted by this instrument. Only one of the program's

milestones required the Greek government to adopt “irreversible decisions by August 2013 on the restructuring, involving substantial downsizing, ahead of privatisation or on the resolution of ELVO, HDS, and LARCO, both in compliance with State aid rules, with a view to implementing these decisions by December-2013” (European Commission 2013).

Nevertheless, the Troika stepped up the use of prior actions to push the government to move ahead with actions on the divestment front as it learned about the main challenges to the implementation of sales. According to a member of the Troika, “the multiplication of prior actions during the second program was aimed at compensating the lack of ownership in areas such as privatization and ensure the implementation of conditionality” (interview 1405).

A prior action for the first review mandated the government to “adopt steps to strengthen the institutional framework for privatization, transfer ownership of assets to the Privatization Fund balance sheet, and eliminate legal obstacles for privatization” (European Commission 2012, 171). This provision referred to an Annex that stipulated eleven policy changes the government would have to adopt, from measures to strengthening the institutional framework for privatization to the additional transfer of public assets to the HRADF. Similarly, the third review required the Greek authorities to “remove obstacles in the privatization program” (European Commission 2013d, 127), while the fourth review mandated the government to adopt a law to “strengthen HRADF's control in companies in which it is majority shareholder, and implement pending government actions in support of the 2014 privatization program” (European Commission 2014, 169). The government implemented all the prior actions on privatization.

Conditionality also became much more specific in the second program. For instance, an annex included in the first review specified a host of detailed privatization-related actions that the government would have to undertake (European Commission 2012d, 178). Policy conditions became more thorough with each review, with the fourth evaluation listing all the pending steps regarding the divestment of the assets listed in the privatization plan (European Commission 2014, 125). The second program also included more extensive institutional reform conditionality, with the Troika mandating very precise legal changes to the HRADF to ensure the independence of its board and its ability to exercise power in those companies where it was a shareholder.

Program outcomes

The Troika updated the goal for privatization receipts at the outset of the second program, which still aimed to reach the EUR 50bn goal, albeit over a longer time horizon. The initial conditions expected the Greek government to obtain at least EUR 5.2bn by the end of 2012, EUR 9.2bn by the end of 2013, EUR 14bn billion by the end of 2014, and EUR 19bn by the end of 2015 (European Commission 2012a, 31). While yearly goals were eventually revised down during the program, the IMF claims that, during the 2012-2014 period, "privatization proceeds were EUR 1.9bn during the program period, representing about 10% of the initial program target" (International Monetary Fund 2017, 19).

Despite not reaching the proposed sales objective, the government made comparatively more progress on the privatization front than under the first program. For instance, the state sold its 33% stake in OPAP to the Greek-Czech fund Emma Delta. It also agreed to sell 66% of the gas transmission system operator DESFA to

Azerbaijani oil company SOCAR and conducted the sale of several real estate assets.[62] Moreover, the government completed or made progress on the tenders for the old Hellenikon airport, the Piraeus port, regional airports, and the Thessaloniki water company (International Monetary Fund 2014, 17). However, asset sales still faced some significant challenges. For instance, the sale of natural gas firm DEPA failed because of limited investor interest.[63]

The higher determinacy of the conditions and the increasing link between conditionality and its implementation forced the government to make progress on the privatization front, with the government implementing all the required prior actions. Moreover, the increasingly detailed conditionality significantly limited the margin of maneuver of Greek policymakers, with a high-level member of the government in charge of implementing the program suggesting that conditionality was "dictating us even how to breath" (interview 1104).

The higher initial credibility of conditionality reinforced the external constraint created by the third program compared to the first EAP. Following the standoff between Papandreou and the international lenders in 2011, the threat of a potential removal of financial assistance became more credible, at least initially. During the negotiations over the second program, key Greek decision-makers believed they had a choice between implementing the new program or leaving the euro (interview 1111). Moreover, the German government allegedly floated the idea of a temporary Greek exit from the common currency, which was discussed in meetings of EU finance ministers (Djankov 2014, 169). However, the Greek government strongly

[62] However, the DESFA deal would eventually collapse, more on this below.
[63] Reuters (2013) *Privatisation of Greek gas firm DEPA fails*, 10 June: https://www.reuters.com/article/uk-greece-privatisation-despa-idUKBRE9590FU20130610

rejected it, agreeing instead to implement the second program fully as a way of avoiding any possibility of having to exit the common currency area (interview 1110).

However, the credibility of the threat diminished as the financial position of the Greek sovereign improved during the program, with market conditions improving in the first half of 2014 and the government able to issue five-year bonds in April. This reduction in perceived credibility was expressed in the willingness of the Greek executive to bargain hard in the face of adverse political conditions. With a presidential election approaching and EU creditors reluctant to provide further debt relief as previously signaled, PM Samaras stated in September that Greece would pursue a clean exit when the EU-supported program expired at the end of the year. [64] He also suggested the government was considering forgoing the remaining IMF loan funds (the IMF program did not expire until mid-2016). Moreover, a standoff emerged between the government and the lenders over the policy actions to close the fifth review, which finally led the Eurogroup to conclude that it was not possible to negotiate an exit from the program (Visvizi 2016, 161). In sum, the higher credibility of the international lenders as a result of the negotiations over the second program led to an intensification of privatization activity. However, institutional and economic challenges lingered, and the government's changing cost-benefit calculus put a halt to privatizations when the program eventually collapsed.

4.4.4 Third Economic Adjustment Program (2015-2018)

Following a series of failed parliamentary votes to elect a new president in December 2014, legislative elections were held a month later. The radical-left party SYRIZA won the 25 January poll, and a coalition government with the populist right-

[64] Macropolis (2014) *How Samaras backed himself and Greece into a corner over bailout exit*, 24 October: https://www.macropolis.gr/?i=portal.en.the-agora.1635

wing Independent Greeks (ANEL) party was agreed upon shortly after, headed by SYRIZA leader Alexis Tsipras. The appointment of the new government marked the start of a dramatic standoff between Greece and its creditors. Following a meeting with Eurogroup President Jeroen Dijsselbloem, Greek Finance Minister Yanis Varoufakis announced that the Greek government would no longer cooperate with the Troika.[65] This stance led to prolonged negotiations to find a deal, which became more pressing as Greece started running out of cash in June and capital outflows increased. After a succession of meetings, negotiations reached an impasse when the Eurogroup asked Greece to present additional fiscal measures to the ones it had submitted on 22 June.

With the government under increasing domestic political pressure, Tsipras decided to call a referendum on the terms offered by the creditor, campaigning against the deal. The "No" option won by 20 percentage points on the 5 July vote. However, when new Finance Minister Euclid Tsakalotos – Varoufakis had been forced to resign the day after the referendum – traveled to Brussels on 7 July for a Eurogroup meeting, he was presented with a stark choice by EU creditors: to agree on a new deal or to face bankruptcy.[66] Soon after, the Greek government applied for a third package from the ESM, pledging to start immediately the implementation of tax and pension reforms, some of which were passed by the Hellenic Parliament on 11 July.[67] After further negotiations in which the German finance ministry circulated a non-paper suggesting the temporary exit of Greece from the Eurozone to pressure the Tsipras administration,

[65] BBC News (2015) *Greece's Varoufakis: 'No debt talks with EU-IMF troika'*, 30 January: https://www.bbc.co.uk/news/world-europe-31055069

[66] Financial Times (2015) *Greece given 5-day deadline to avoid bankruptcy*, 7 July: https://www.ft.com/content/2c6a913c-2472-11e5-bd83-71cb60e8f08c

[67] The Guardian (2015) *Greek crisis: Athens submits request for third bailout*, 8 July: https://www.theguardian.com/business/2015/jul/08/greek-crisis-alexis-tsipras-confident-meeting-bailout-deadline

and the passage in the Greek parliament of additional measures required by creditors, a third program was finally agreed on 18 August.[68]

Privatizations were one of the main points of contention during the initial program negotiations. The German government suggested the creation of a privatization fund outside Greece to manage asset sales and use the expected EUR 50bn in revenues to pay for Greek debt (Dijsselbloem 2018, Loc. 2620). The controversial proposal was ultimately discarded, and an agreement to use part of the money to pay for bank recapitalizations was reached (Blustein 2016, 440). Nevertheless, the government reversed its previous promise to halt asset sales, committing instead to a wide-ranging privatization program to avoid having to exit the Eurozone.

Perceived domestic opposition to privatizations

The hard initial stance of the SYRIZA-led administration against privatizations significantly increased the perceived domestic political opposition to asset sales. For instance, several members of SYRIZA – including Tsipras– had promised on several occasions to reverse privatizations, and one of the new cabinet's first decisions was to halt the planned sales of the Piraeus port,[69] as well as that of the Public Power Corporation and 14 regional airports.[70] Moreover, the SYRIZA-led government also initially mandated the management of HRADF to resign with the intention of winding the agency down.[71]

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[68] The Guardian (2015) *Three days that saved the euro*, 22 October: https://www.theguardian.com/world/2015/oct/22/three-days-to-save-the-euro-greece
[69] Reuters (2015) *Greek PM Tsipras names anti-austerity cabinet, port sale halted*, 27 January: https://www.reuters.com/article/us-greece-election-finmin-idUKKBN0L00QU20150127
[70] Financial Times (2015) *Greece backtracks on privatisations*, 4 February: https://www.ft.com/content/b3f7a5b0-ac61-11e4-af0e-00144feab7de
[71] Kathimerini (2015) *TAIPED is stripped of its management and most projects*, 30 January: https://www.ekathimerini.com/economy/166782/taiped-is-stripped-of-its-management-and-most-projects/

From a broader standpoint, the sequence of the initial negotiations and Tsipras's decision to call a referendum on the terms of the bailout significantly eroded Greece's credibility vis-à-vis its Eurozone counterparts. Even ministers from countries not traditionally considered "hardliners" during bailout negotiations suggested the Greek government could not be trusted to implement its reform commitments (Dendrinou and Varvitsioti 2019, 280). For instance, when describing why Eurozone ministers were struggling to reach a deal with Greece after the referendum, former Italian Economy Minister Pier Carlo Padoan said: "let's face it, the main obstacle to moving forward is lack of trust."[72]

A member of the institutions described how trust continued to be low even after Tsipras's U-turn, with the government "passing legislation at the 11th hour and doing things only if they were under duress" (interview 1304). Members of the Greek government confirmed that the implementation of the new program translated into frequent internal conflicts within the government (interview 1105), with energy and infrastructure privatizations generating significant resistance (interview 1115).

Evolution of conditionality

Given the international lenders' deep mistrust of the government, conditionality was made even harder than during the second bailout. The third program saw indeed an unprecedented multiplication of prior actions and milestones, further tightening the link between the implementation of conditions and the provision of funding. Regarding privatizations, the initial MoU outlined several prior actions. The government was expected to endorse the so-called Asset Development Plan (ADP,

[72] France 24 (2015) *'Greek compromise proposed' by Tsipras, Hollande and Merkel*, 12 July: https://www.france24.com/en/20150712-live-eurozone-leaders-meet-decide-greece-fate-bailout-debt-european-union

more on this below) and update it semi-annually.[73] The Memorandum also required the Greek authorities to "announce binding bid dates for Piraeus and Thessaloniki ports of no later than end-October 2015, and for TRAINOSE ROSCO, with no material changes in the terms of the tenders," as well as to make progress in the privatization of the regional airports (European Commission 2015b, 38) Furthermore, the government was expected to implement 20 pending actions identified by the privatization Fund (ibid.).

Such an approach was especially more prominent during the first months of the program, as the EU made the disbursement of sub-tranches of financing conditional on the implementation of several milestones. For instance, the disbursement of a sub-tranche in December 2015 required the government to implement three privatization milestones, including creating a new privatization fund and completing further pending actions (European Commission 2015, 7). The first review also required the completion of six milestones for the disbursement of a EUR 1.1bn sub-tranche (European Commission 2016a). Overall, the four supplemental MoUs that updated the conditionality the government had to implement during the program laid out 40 prior actions targeting privatization policy.

The much stronger link between conditionality and funding was matched by a formidable leap in the precision of the policy prescriptions regarding privatization in the third program. One crucial example is the prominence of the ADP within conditionality, with the initial MoU mentioning that the plan was "an integral part of the agreement" (European Commission 2015b, 28). The ADP, which was updated twice a year, included the list of assets to be sold by the HRADF, with detailed data

[73] The program initially aimed to obtain EUR 1.4bn in privatization receipts in 2015, EUR 3.7bn in 2016 and EUR 1.3bn in 2017 (European Commission, 2015).

on the privatization method to be used, the appointed advisors who would support the process, its status, and the next steps and any issues identified by the fund regarding the sale. Moreover, each program review included an extensive list of "pending actions" regarding privatizations, with the first review identifying as many as 39 items (European Commission 2016b).

In addition to the measures to boost asset sales, conditionality also required the government to implement yet another major institutional reform to improve the governance framework of privatization policy. The MoU expected the government to create a new "independent" fund that would "manage valuable Greek assets" to "protect, create and ultimately maximize their value, which it will monetize through privatisations and other means." (European Commission 2015b, 28). The second supplemental MoU provided a lengthy description of the required characteristics of such a fund, which would be "under professional management at arm's length from the State" (European Commission 2016e, 46). This led to the creation of the Hellenic Corporation of Assets and Participations (HCAP), whose Board of Directors was supervised by a board in which two members were to be nominated jointly by the European Commission and the ESM.[74] The new institution would have a broader mandate than the HDRAF, sitting above the privatization agency from an organizational standpoint. The third supplemental MoU laid out detailed guidelines on how the HCAP should operate, for instance, by establishing a mandate to "fill the vacant posts in the board of TAIPED and replace executive and non-executive members if needed" (European Commission 2018, 40).

[74] Law 4389/2016.

Program outcomes

The evaluation of the third program by the ESM highlighted the "delayed privatization efforts" and the fact that expected receipts from sales had fallen below the intended targets (European Stability Mechanism 2020). Nevertheless, asset sales significantly accelerated during the third program, and the Greek authorities completed many more privatizations than in the previous programs[75]. These included some flagship assets such as the sale of 51% of the Port of Piraeus to Chinese company COSCO Shipping, giving German company Fraport the right to run 14 regional airports for 40 years, the sale of 100% of railway company TrainOSE to Italian firm Ferrovie Dello Stato, or the sale of a 24% of the electricity grid operator ADMIE to China's State Grid. It should be noted that these sales entailed a significant change in the privatization strategy pursued by previous governments in the years prior to the bailouts, with the state now significantly reducing the amount of direct and indirect control over privatized assets in some cases.

The strategy of linking the provision of loan installments to the implementation of specific measures "had put significant pressure on the government to deliver on its loan commitments," as confirmed by a high-level Greek government official (interview 1105). The lack of access to sovereign debt markets and the poor state of public finances meant the government was constantly running out of cash to cover key state expenditures, such as public wages, which created a strong incentive to implement the program's conditions (ibid.).

The negotiation dynamics of 2015 made the possibility of a euro-exit very material in the eyes of Greek decision-makers. The increased credibility of the threat

[75] See Annex 2 of this dissertation.

of ending financial assistance to Greece led to a significant recalculation of the Greek government's costs and benefits of implementing the loan terms. Such a turn was caused by fears about the potentially catastrophic economic and social consequences of an exit from the common currency area. The fact that privatization policy was a centerpiece of the negotiations with the international lenders added an extra layer of pressure on the Greek authorities. Key policymakers indeed perceived Tsipras's U-turn as a tipping point in the Greek authorities' commitment to delivering asset sales (interview 1116).

Moreover, the increased determinacy of the conditions also allowed the lenders to increase the independence of the HRADF and further shield it from political interference, with a high-level government official suggesting in an interview that the agency had full liberty in designing and executing the sales under the SYRIZA-led government (interviews 1116). The requirement that the CEO and Chairman should be hired through an open tender was also perceived as a feature that reinforced the independence and expertise of the fund's management (interview 1115). The creation of the HCAP in 2016 entailed a further step by the lenders to control the domestic policy-making process over privatization by adding a new layer of external control.

4.5 Discussion and conclusions

The evidence provided by the cross-time case study of the negotiations and implementation of privatization conditionality during the three bailouts confirms the proposed hypotheses derived from the two-level framework. Conditions promoting asset sales in the first program were initially rather sparse, aimed mostly at preparing the ground for privatizations. Policy prescriptions targeting privatizations became slightly more determinate as the Troika became aware of the political and institutional obstacles to privatization, as predicted by the first hypothesis. However, the changes

in conditionality did not lead to a substantial change in the dynamics underpinning the government's privatization policy. Asset sales faced significant political resistance, and the inclusion of an unrealistic target for asset sales in the program conditions severely undermined the credibility of conditionality.

The limited progress on the privatization front in the first program led the Troika to make conditions more precise and their link to funding stronger in the second program. The credibility of conditionality was initially reinforced by the emergence of the possibility of Euro-exit during the initial negotiations. Nevertheless, domestic resistance to privatizations was also substantial, leading the Troika to step up its coercive strategies in the form of additional prior actions and much more detailed policy conditions during the program. While asset sales gained pace, the program eventually collapsed when the Samaras administration decided to bargain hard in the face of better financial conditions and a worsening political environment.

Meanwhile, the negotiations over the third program only intensified the dynamics seen in the previous bailouts. As the Tsipras administration was forced to make a U-turn on its promise to reverse privatizations in the face of a potential exit from the Eurozone, international lenders stepped up their coercive strategies by linking policy conditions much more strongly to funding, redefining the prize offered to the Greek government. In the third program, the EU ended up essentially guiding the policy process of privatization through the setting of a highly constraining environment that forced the government to push for sales despite intense internal political opposition, as expected by the second hypothesis.

By providing a comprehensive account of privatization policy under conditionality in Greece, this paper makes two contributions to the literature. The first

is to show that, in a context of repeated interactions, international lenders embed coercive threats within conditionality to prevent defection from the loan terms by the borrower government when they acquire information about potential obstacles to implementation. In other words, international bureaucrats solve commitment problems through the design of policy conditions. However, and in line with the two-level game framework, such a strategy is only effective when the borrower government perceives that the creditors are willing to "ratify" (i.e., execute) the threat of withdrawing financial assistance (Moravcsik 1993, 29).

The second contribution refers to the importance of domestic policymaking processes for the implementation of conditionality. A core assumption of explanations based on costly signaling is that for threats to be effective at promoting reforms under conditionality, the ruling politicians of the borrower government need to be able to have enough discretion vis-à-vis bureaucrats regarding the enforcement of conditions (Hennessy 2017, 747). Yet the case study suggests the international lenders crafted conditions precisely in a way that would minimize politicians' discretion over privatization policy by making conditionality extremely determinate and substantially enhancing the independence of the bureaucratic units in charge of selling public assets. Therefore, credible signaling seems to be more effective when filtered through a policy-making system in which bureaucrats are insulated from political pressure.

The findings have normative implications regarding the democratic viability of conditionality as it was applied during the Eurozone crisis. As suggested by Spanou (2016, 54), conditionality aims to "guide" the domestic governance process, manifesting "an underlying clash between a deeply technocratic approach to policy reform and its political prerequisites." Privatization policy in Greece under conditionality provides a good example of this tension. In addition to constraining the

government's policy space via conditionality, the EU and the IMF sought to actively depoliticize the management of state assets through institutional reforms. While the adopted changes might have increased the implementation capacity of the bureaucracy, they have also generated questions of democratic accountability, given it transferred part of the authority over privatization towards supranational institutions (Lampropoulou and Oikonomou 2020). In this regard, the EU’s strategy only exacerbated the Eurozone’s trilemma identified by Featherstone (2016): the challenge of combining democratic choice with program compliance in crisis countries with low capacity to deliver reforms.

Although the Covid-19 crisis has arguably led to softer forms of conditionality in exchange for EU funds (for instance, regarding the new Resilience and Recovery Facility), the rules underpinning crisis lending remain unchanged, as loans from the ESM are still subject to strict conditionality. This might explain why countries such as Italy were rather reluctant to resort to ESM funding during the height of the coronavirus crisis. Given the lack of reform of crisis lending conditionality, it remains to be seen whether future crises will lead to the re-emergence of the systemic problems that the Eurozone faced during the first half of the last decade and whether the integrity of the common currency area itself will again be tested.

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5 - *Conclusions*

The empirical chapters of this dissertation have examined from different angles how the interaction between international and domestic politics shapes economic policy under conditionality in the Eurozone. The second chapter (Paper 1) has analyzed whether governments dispose of sufficient room for maneuver to design and implement economic policies in line with their preferences. The third chapter (Paper 2) of the thesis has looked into the factors that lead borrower executives to manipulate international and domestic constraints to their advantage. The fourth and final empirical chapter (Paper 3) of the dissertation has explored the circumstances under which conditionality leads to the implementation of policy changes in countries with limited reform capacity.

In this concluding chapter, I summarize the key findings of the three papers and highlight their contributions to the literature. I also review the limitations of my research and sketch potential avenues for further research. The final section of the chapter proposes several policy implications that stem from the dissertation.

5.1 Summary of key findings

The three empirical chapters of the dissertation have looked at the impact of conditionality on three policy areas in different Eurozone countries through the analytical lens of Putnam's (1988) two-level game. The insights from each paper can be summarized as follows. The first paper has examined the politics of fiscal consolidation under Eurozone conditionality by looking at the cases of Greece, Ireland, and Portugal during their respective EAPs. It has addressed the puzzle created by the fact that certain governments could not deliver expenditure-based consolidations, in line with the wishes of the Troika and their own preferences in the case of center-right

governments. The paper is the first study to explore the politics underpinning the composition of fiscal adjustments under bailout conditionality in the Eurozone and relies on the analysis of data from interviews with some of the key protagonists with decision-making power over fiscal policy matters in the three countries as well as with members of the Troika.

The comparative case study shows that conditionality erased ideological differences regarding the composition of fiscal adjustments, with the governments of the three countries pushing for expenditure-based consolidations at the beginning of their respective programs. The reason for pursuing such an approach is that center-right executives share the international lenders' preference to base adjustments on spending cuts. Meanwhile, center-left governments are pushed to follow the same adjustment path because of the power asymmetry built into conditionality. Given the high cost of no agreement for borrower governments, center-left executives have limited power to push for a revenue-based consolidation, which tends to be their preferred option.

Once governments start executing their respective consolidation strategies, however, even center-right executives see their margin of maneuver shrink when facing fiscal slippages due to factors outside their control, such as economic underperformance and domestic vetoes to spending cuts. Since international lenders prioritize meeting the deficit goals agreed upon in conditionality negotiations, borrower governments are forced to hike taxes to quickly capture as much revenue as possible to cover the fiscal slippages. The result is that delivering an expenditure-based consolidation becomes impossible for the borrower government. Therefore, even the mere pursuit of targets can lead to a reduced policy space for governments under conditionality.

The second paper has looked at labor reforms under conditionality during Portugal's EAP, with a specific focus on deregulatory reforms in the areas of employment protection legislation (EPL) and collective bargaining. Having been elected on a reformist platform in the election that preceded the implementation of the bailout, the center-right Portuguese executive took advantage of conditionality to push for reforms it favored. However, a government whose preferences were supposedly strongly aligned with those of the Troika ended up pushing back against the IMF's demands for further reforms during the second half of the program, which poses a puzzle.

The empirical evidence from the paper shows that the Portuguese executive used the external constraint provided by conditionality to overcome domestic resistance to deregulatory labor reforms as long as it faced a low risk of being replaced in an election and while the cost of forgoing EU/IMF assistance was relatively high. However, the government reversed this strategy when it started to fear the electoral costs of implementing reforms mandated by conditionality. As Portugal's sovereign funding prospects improved and the cost of no agreement went down, the government used domestic constraints such as a potential increase in protests by trade unions to push back against demands from the IMF to implement further changes to the country's jobs market. The cross-time case study demonstrates that the different incentives faced by international bureaucrats and national politicians explain why a reformist government might be willing to tie its hands vis-à-vis domestic interests but also use domestic constraints to extract concessions from the international lenders. The paper is the first study to suggest that both strategic behaviors are compatible under conditionality.

The third and final paper took the puzzle provided by the evolution of reforms in Greece under its bailouts as its point of departure. Prior to the crisis, multiple studies had pointed to the country's limited capacity to implement structural reforms of the type EAPs would eventually require. However, Greece delivered a substantial amount of policy reforms under conditionality, such as an intensification in the privatization of state assets. Interestingly, the bulk of asset sales took place under the third program, which is counterintuitive given they were executed under a government led by the radical left party SYRIZA.

The paper shows that the increase in privatization activity resulted from changes in the design of conditionality during the three programs, which changed the external incentives for the different Greek executives. Through their interaction with the Greek authorities in their monitoring activities, the international lenders updated their beliefs about the main domestic obstacles to divestiture, consequently altering conditionality to prevent the Greek government from defecting from the loan terms. In doing so, they relied on two different levers. First, they made conditionality much more specific with the goal of reducing the ambiguity of the prescriptions and limiting the space for divergent interpretations of the required policy actions by the Greek authorities. Second, they strengthened the link between the implementation of the conditions and the provision of funding via the inclusion of an increasing number of prior actions in MoUs. In other words, the lenders embedded the coercive threat of removing financial assistance in the loan terms.

This strategy became effective the more the creditors' threat of walking away from the program became credible, which was especially the case during the third program. As Germany and other Eurozone countries flirted with the idea of Greece exiting the Eurozone, Greek decision-makers believed the withdrawal of financial

assistance was a very material possibility in the event of non-implementation of conditionality. Since privatization was a centerpiece of the third program, the government had no other option but to push for the necessary policy changes to facilitate the sale of state assets. The paper also underscores that the lenders tried to limit the risk of political interference in privatization processes as much as possible by requiring the government to implement institutional reforms to increase the independence of the bureaucratic unit in charge of delivering asset sales. In sum, conditionality led to a substantial amount of reform in a country with traditionally limited capacity for policy delivery, but at the cost of significantly constraining the ability of elected politicians to make choices.

These insights from the three papers make for several important theoretical contributions to several strands of the literature. These contributions are explained in the following section.

5.2 Contributions to the literature

5.2.1 Policy space of governments

Starting with the debate on whether borrower governments had enough wiggle room to make policy choices according to their preferences, recent research has claimed that European executives had some space to determine the policy changes mandated by the MoUs (Hick 2018; Moury et al. 2021). However, the dissertation shows that certain governments enjoyed less room for maneuver than previously assumed. Taking the example of fiscal policy, some executives might have initially had the freedom to decide on the design and timing of consolidation measures. Still, such leeway was significantly reduced in the face of implementation constraints. For example, the urgency of fiscal targets meant that Portugal and Greece had to raise taxes

quickly when facing fiscal slippages, which reduced their ability to control the process of fiscal adjustment.

To be sure, the literature expects borrower governments to enjoy less leeway in designing measures that are salient for the lenders, such as those on the fiscal policy front (Moury et al. 2021, 25). Still, one of the main innovations of the thesis is to show that even when the lenders prioritize the fulfillment of targets over the design of measures, the range of policies that European executives can adopt in the face of implementation constraints shrinks substantially. The irony of this result is that governments end up delivering policy outputs that depart from those favored by EU and IMF bureaucrats.

The case of privatization policy is also revealing concerning the pursuit of "broad goals" by the lenders. The lenders initially focused primarily on the achievement of revenue targets by borrower governments regarding asset sales. In the case of Greece, however, conditions became much more specific as implementation constraints dragged the divestiture process, which, in turn, significantly limited the ability of the Greek executive to make choices. Therefore, one of the crucial theoretical contributions of the dissertation is to show that we need to pay greater attention to how the interaction between program design and implementation constraints shapes the ability of borrower governments to make policy choices under conditionality.

By looking at the policy space issue, the thesis also connects with a wider debate about the relevance of partisanship for economic policies in the current era of economic interdependence. For instance, the literature on the composition of fiscal consolidation has pointed to the continued importance of the ideological preferences of governments regarding the choice of adjustment strategies (Castles 2007; Mulas-

Granados 2006; Perroti 1996; Perroti and Kontopoulos 1999; Tavares 2004). Yet, the dissertation suggests conditionality erases ideological differences regarding the composition of fiscal consolidation. Adjustment packages in the Eurozone initially reflected the preferences of the lenders, who used the leverage provided by financial assistance to convince left-wing governments to push for expenditure-based consolidations. Whether an executive delivered such an adjustment during a program was then a function of implementation constraints. Interestingly, the dissertation suggests conditionality does play a role in determining the composition of fiscal consolidations, against the findings of the IMF literature, which shows the impact of programs on the balance between expenditure cuts and revenue increases is not significant (Bulíř and Moon 2004).

Beyond fiscal policy, the diminished relevance of partisanship under conditionality also seems to apply to privatization policy. The case of Greece shows that even a radical left government strongly opposed to divestiture was forced to push for asset sales during the program. Such insight goes against recent research suggesting that the lenders allowed borrower governments to shape conditionality according to their ideological preferences (Genovese and Hermida-Rivera 2022). It also runs contrary to the insights of both the literature on the political economy of privatization in advanced economies (Bjørnskov and Potrafke 2011; Boix 1997; Bortolotti, Fantini, and Siniscalco 2004; Doyle 2010; Zohlnhöfer, Obinger, and Wolf 2008) and on asset sales under IMF programs (Doyle 2012) that highlight the continued relevance of the ideological preferences of governments.

Finally, the contribution of this thesis to the debate about the policy space of Eurozone borrower governments also adds to ongoing normative discussion about the tensions between democratic and technocratic authority in the European Union. As

Sánchez-Cuenca (2017) argues, the Eurozone crisis significantly expanded the technocratic elements of European integration, such as the use of binding rules on economic matters. Eurozone crisis lending conditionality can be considered an extreme example of such a trend since it reduces the ability of national parliaments to impact policy outcomes (Closa Montero, González De León, and Losada Fraga 2020, 59; Spanou 2016). Certain authors claim indeed that technocratic rules were coercively enforced through the pressures created by the urgency of crisis resolution (Scicluna and Auer 2019). The findings from the dissertation seem to lend support to this view. Even when borrower governments had similar views to those of EU and IMF technocrats, such in the case of Portugal, the constraints created by the pursuit of restrictive policy goals ended up limiting the ability of the executive to be responsive to its electorate. Moreover, when the preferences of the borrower governments diverged significantly from those of the lenders, the latter's response was to reduce even more the ability of domestic politics to influence economic policy decisions.

The recent creation of the National Reform Plans (NRP) that member states have to elaborate to obtain funds from the Recovery and Resilience Facility (RRF) seems to have reduced – if not eliminated – the tension between top-down technocracy and national democracy by giving governments the predominant role in elaborating reform commitments. However, the rules of crisis lending conditionality remain unreformed, which means that the risk of another shock producing negative democratic implications remains very much alive.

5.2.2 Strategic use of conditionality by governments

The thesis also reconciles the two main predictions made by the conditionality scholarship regarding the strategic behavior of borrower governments. To recap both

arguments, the literature predicts that reform-minded executives sometimes use the external constraint provided by conditionality to overcome domestic opposition to policy changes (Drazen 2002; Lütz, Hilgers, and Schneider 2019b; MacCarthaigh and Hardiman 2020; Moury and Standring 2017; Rogers 2009; Vreeland 2003b). In contrast, other studies claim that certain executives use domestic constraints to obtain more lenient conditionality in their negotiations with the lenders (Caraway, Rickard, and Anner 2012; Rickard and Caraway 2014). I demonstrate that both courses of action are compatible during a program. My main theoretical innovation on this topic is to specify the factors that lead a reform-minded government to choose one of the two strategic behaviors in the two-level game of conditionality.

The dissertation points to the importance of borrower governments' electoral concerns and bargaining power as factors that influence their strategic calculations. Reformist executives are willing to collude with the lenders to overcome domestic resistance to reforms they both favor. However, the incentives of unelected international bureaucrats differ from those of elected politicians who, in addition to making policy, also want to keep holding office (Meyer and Wagner 2014; Müller and Strøm 1999; Pedersen 2012). Therefore, even reformist governments are willing to use domestic constraints to extract concessions in conditionality negotiations when they fear economic reforms might hurt their re-election chances.

In addition to electoral concerns, the bargaining power of executives, which is dictated by the cost of no agreement, also plays an important role in the strategic use of conditionality. A high cost of no agreement allows a borrower government to transfer the external pressure created by conditionality to domestic constituencies to overcome their resistance to reform. However, when the cost of no agreement decreases, so does the ability of executives to use conditionality strategically at home.

Moreover, as governments regain access to sovereign debt markets, politicians become more willing to use domestic constraints to reforms to extract concessions in negotiations if they believe that the implementation of further policy changes mandated by conditionality will hurt their political interests.

By highlighting the importance of electoral concerns and the cost of no agreement, the thesis also informs the broader literature on two-level games. As Rickard and Caraway (2014) state, the "Schelling paradox" (Schelling 1960) has been subject to few empirical tests. A recent review of the application of Putnam's theory to a broad range of areas also called for further research into understanding the conditions under which governments are willing to use domestic constraints strategically to obtain an advantage in international negotiations (da Conceição-Heldt and Mello 2018). Therefore, my research contributes to the two-level game literature by advancing two factors (electoral concerns and the cost of no agreement) that influence borrower governments' decisions to exploit their domestic weakness to get a better deal abroad.

5.2.3 Implementation of reforms under conditionality

The dissertation also contributes to the literature by showing that external incentives are key to ascertaining why a country with limited will and capacity to implement deep reforms mandated by conditionality would push for such policy changes. I demonstrate that international lenders alter the payoffs stemming from the implementation of conditionality by making policy conditions stricter, provided that they can also credibly threaten borrower governments with the withdrawal of financial assistance in the event of non-compliance. Put differently, recalcitrant borrower governments will push stronger for policy changes the harder and more credible

conditionality becomes. Therefore, the thesis points to the applicability of existing EU conditionality theories (Schimmelfennig and Sedelmeier 2004, 2020) for explaining the adoption of economic reforms under the policy prescriptions of EAPs.

Another significant theoretical implication from my research is to show that the lenders' credible signals work when the discretion of the borrower government vis-à-vis domestic bureaucrats is reduced, contrary to what Hennesy (2017, 747) claims. In fact, the thesis suggests lenders push for the depoliticization of certain bureaucratic units to reduce the risk of the potential interference of political actors with policy delivery and promote compliance with conditionality, as suggested by works focusing on IMF programs in developing countries (Reinsberg, Kern, and Rau-Göhring 2021). As a result, the dissertation helps to develop a better understanding of how signaling works in international conditionality negotiations by highlighting the importance of enforcement mechanisms for the processing of signals by the domestic policy-making system.

Finally, the dissertation demonstrates that lending organizations sometimes solve commitment problems via program design, an insight that has relevance to the literature on IMF programs. Scholars studying IMF conditionality have explained the differences in program design as a function of a wide range of factors, such as the geopolitical preferences of the Funds' most powerful members (Breen 2013; Copelovitch 2010; Dreher and Jensen 2007; Dreher, Sturm, and Vreeland 2009; Kang 2007; Oatley and Yackee 2004; Stone 2008, 2011) or the normative and cultural orientations of IMF staff (Barnett and Finnemore 2004; Chwieroth 2010, 2015; Momani 2005). The thesis shows that this field of research would benefit from studying how lending organizations deal with implementation risks in certain countries and how they shape conditionality accordingly. Only by understanding the dynamic

character of crisis lending conditionality can we fully ascertain the factors that explain how policy conditions are crafted.

Before turning to the potential limitations of my research in the next section of these conclusions, the table on the next page summarizes the main insights from each paper and their theoretical contributions.

Table 5.1: Summary of the dissertation's insights and theoretical contributions

Title of the paper	Debate	Insights	Main theoretical contributions
Maastricht on Steroids: The Political Economy of Fiscal Consolidations in Eurozone Bailouts	Policy space of governments under conditionality	- Eurozone borrower governments initially pursued expenditure-based consolidations regardless of their ideological preferences. - Externally-imposed deficit targets led Eurozone borrower governments to hike taxes when faced with fiscal slippages due to factors outside their control.	- The interplay between program design and implementation constraints crucially shapes the policy space of borrower governments. - Conditionality erases ideological differences between governments regarding the composition of fiscal consolidation.
Bonds, Ballots, and Tied Hands: The Politics of Labor Reform under Conditionality in Portugal	Strategic behavior of governments under conditionality	- The Portuguese government used the external constraint provided by the Troika to override domestic constraints and implement labor reforms it favored. - The Portuguese executive also used domestic constraints to push back against the Troika's demands for further reforms as electoral risks increased and the cost of forgoing financial assistance went down.	- Electoral considerations shape governments' incentives to behave strategically under conditionality. - The cost of no agreement influences the decision to use conditionality and domestic constraints in two-level game negotiations strategically.
Selling the Family Silver under Pressure: Privatization in Greece during the Eurozone Crisis	Implementation of reforms under conditionality	- International lenders hardened conditionality in the Greek programs the stronger the perceived domestic resistance to privatizations. - Despite the strong domestic obstacles to privatization, the Greek government pushed for asset sales the harder conditionality became and as the potential withdrawal of financial assistance by the creditors became more credible.	- The more restrictive conditionality becomes, the more a reform-skeptic borrower government pushes for policy changes. - Coercive threats translate into reform implementation when politicians' discretion over the enforcement of the policy prescriptions is low. - International lenders overcome commitment problems through program design.

5.3 Limitations and avenues for further research

My thesis focuses on how governments implement economic policies under conditionality in the Eurozone. As mentioned in the empirical chapters, this somehow limits the applicability of the research's lessons outside the EU for two reasons. First, there is a strong economic interdependence between EMU members, which means creditors are themselves impacted by crisis lending decisions (Hennessy 2017). Moreover, the potentially exorbitant costs of exiting a common currency area are not present outside the Eurozone, which means strategic calculations about the cost of no agreement are different in other contexts. Second, although MoUs replicated the template of IMF-style conditionality, they also promoted compliance with EU rules such as the EDP or internal market legislation (Lütz, Hilgers, and Schneider 2019a), which are not present in other cases where structural conditionality is applied.

Regarding the first issue, future studies could nevertheless apply the insights of the dissertation outside Europe by examining cases where the behavior of a borrower government can have systemic effects on a specific region or wider set of economies. Such a situation might arguably exhibit comparable dynamics regarding the strategic calculations of creditors and debtors in conditionality negotiations. As for the role of EU norms such as fiscal rules, more research could be conducted on how program design in specific policy areas affects economic policymaking outside of Europe, especially given the evidence provided by the IMF literature on how conditionality affects fiscal policy is far from clear-cut (Clements, Gutpta, and Nozaki 2011; Garuda 2000; Hajro and Joyce 2009; Kentikelenis, Stubbs, and King 2015; Martin and Segura-Ubiergo 2004; Nooruddin and Simmons 2006; Nooruddin and Vreeland 2010; Oberdabernig 2013). One potential topic to explore in this regard is

the analysis of how the IMF approaches fiscal targets in its arrangements and how these impact the consolidation strategies adopted by borrower governments.

Also, I treat borrower governments mostly as monolithic entities, speaking with a single voice at both the international and the domestic levels. Such a decision stems from the application of Putnam's analytical lens to my case studies. The theory assumes that governments and international institutions are represented by a "chief negotiator" (Putnam 1988, 435), which allows for a more parsimonious analysis of how the "process" of conditionality (Sasse 2008) plays out. At the same time, this focus leaves out the potential impact that relevant individual actors, such as key cabinet ministers, and their idiosyncratic interests and preferences might have on conditionality negotiations and the implementation of economic policies. For example, recent studies suggest that prime ministers appoint technocrats because of their commitment to pro-market reforms and to signal economic credibility to investors (Alexiadou and Gunaydin 2019; Alexiadou, Spaniel, and Gunaydin 2022). Future research could build on the insights of this thesis by looking at whether the appointment of specific profiles to the cabinets of Eurozone borrower countries made a difference in negotiation outcomes – as suggested by the constructivist literature on IMF programs (Chwieroth 2015) – and policy outputs under conditionality.

A promising avenue of further research would be to test this thesis' hypotheses about conditionality in the settings provided by new EU support instruments, such as the Recovery and Resilience Facility (RRF). As explained in the introduction to this dissertation, the RRF does away with the top-down conditionality template used during the Eurozone crisis, favoring instead a bottom-up approach in which national governments come up with reform commitments or National Reform Plans (NRPs) to be implemented in exchange for funds. However, the dynamics

inherent to conditionality are very much part of the process. The executives' performance is subject to the review of the European Commission and the Council, which determines whether funds are disbursed. Therefore, the RRF process can be fertile ground to study, for instance, how a new structure of financial incentives to introduce reforms influence the strategic behavior of governments. Future analyses could examine whether EU governments exploit the potential cost of forgoing RFF funds to convince domestic actors such as trade unions and employers' associations to accept certain economic policy changes. Conversely, further research could examine to what extent electoral concerns lead executives to use domestic constraints to push back against demands by the Commission to commit to specific reforms during the process of elaboration of the NRPs. Such an endeavor would enhance our knowledge of how different EU conditionality arrangements influence member states' adoption of policy reforms.

5.4 Policy implications

Beyond the theoretical contributions exposed in this chapter, my research offers some practical lessons for EU economic governance, both at the supranational and national levels. On the one hand, it can be argued that EAPs were effective in promoting structural change in certain areas and reducing the misallocation of resources that had affected some of the program countries in the years leading up to the crisis, as suggested by Reis (2015) in the case of Portugal. The third paper of this dissertation also shows that even in areas were entrenched interests had thwarted past reform attempts, conditionality fostered the implementation of policy changes. However, the thesis demonstrates that trying to engineer long-term transformations via the quick implementation of policy conditions poses a remarkable challenge for governments. Deep structural changes take time, and the technocratic reform plans mandated by

external conditionality rarely survive contact with the realities of policy implementation. Conditions tend to be restructured by political and economic constraints, which sometimes lead to counterproductive outputs, as illustrated by the case of the fiscal adjustment strategies of bailed-out Eurozone countries.

Extensive conditionality also restricts the ability of national governments to make policy choices, which increases political discontent in borrower countries. Although support for European integration in Southern European countries seems to have recovered following the exit from the Eurozone crisis (Verney and Katsikas 2021), recent evidence has highlighted the risk that the imposition of conditionality during a crisis represents for voter support for the Euro (Baccaro, Bremer, and Neimanns 2021). The bottom-up approach to reforms recently adopted by the EU in relation to the management of the RFF seems to address, to a certain extent, these pitfalls. Still, more research is needed in the future to understand how effective NRPs are in terms of promoting policy changes and to what extent domestic constituencies can influence the elaboration of reforms.

If crisis lending conditionality is to be used to facilitate the macroeconomic adjustment of Eurozone members in financial distress, this dissertation represents a call to pay more attention to program design issues. Regarding fiscal rules, for instance, the thesis shows that the top-down imposition of overoptimistic deficit targets within a rigid framework can substantially undermine the ability of governments to design fiscal adjustments and lead to inefficient outcomes. The corollary is that when fiscal consolidation is needed, establishing a feasible adjustment path increases the chances that the government will adopt measures with long-term impact rather than short-term fixes to meet deficit targets. Establishing a realistic adjustment strategy would require a correct assessment of the country's financial needs, which points to

the relevance of appropriate monitoring and surveillance mechanisms (Savage and Howarth 2018) and the need to produce accurate forecasts regarding the economic performance of member states.

Ultimately, crisis lending conditionality can be no substitute for structural solutions to avoid a repetition of the pitfalls seen during the Eurozone crisis. For instance, completing the Economic and Monetary Union through establishing risk-sharing mechanisms at the EU would go a long way in reducing the divergence between Eurozone members that led to the turmoil that engulfed the common currency area at the beginning of the last decade (Pagoulatos 2021). However, despite the important institutional reforms adopted during the Covid-19 pandemic, the divergent preferences of member states continue to forestall the adoption of reforms that would help prevent future crises (Howarth and Quaglia 2021). One can only hope that this research will serve as a reminder of the risks that returning to the bailout era would entail for European integration.

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Annex 1
Interview Methods Appendix

The table included in this appendix provides the list of individuals interviewed as part of the research undertaken for the dissertation. The information given broadly follows the guidelines suggested by Bleich and Pekkanen (2013) to improve the quality of reported interview data. Below are some observations regarding the key methodological decisions taken during the research process:

Sample frame: As mentioned in the introductory chapter, the individuals belonging to the sample frame were divided into categories depending on their occupation. Category 1 corresponds to the top political decision-makers in borrower governments regarding conditionality negotiations and the implementation of the policy prescriptions. Individuals under Category 2 are high-level decision-makers belonging to EU institutions or the IMF who were involved in conditionality negotiations. Category 3 refers to cabinet-level policymakers (senior and junior) from borrower governments in charge of negotiations and implementing the policy prescriptions. Category 4 concerns officials from the EU and the IMF involved in conditionality negotiations and monitoring compliance with the loan terms, as well as officials from other EU countries who were involved in decision-making at the Eurogroup. Interviewees under Category 5 were individuals responsible for advising government members of the debtor countries on policy matters related to the programs. Category 6 interviewees are personnel from member states' agencies in charge of the technical implementation of specific policy conditions. Category 7 refers to individuals representing trade unions or employers' associations in discussions related to the implementation of conditionality. Lastly, Category 8 refers to researchers and journalists who closely followed the negotiations and the implementation of program

conditionality and have written extensively about it. The final constructed sample included 55 individuals.

The main goal of this categorization was to collect views from a wide range of actors across different levels of decision-making in the case of individuals working for national governments or the EU and the IMF. However, given that the analysis in each paper concerned key decision-making points during the negotiations and the implementation of the conditions, I decided to interview a larger number of subjects from Categories 3 and 4.

Response rate/Snowballing: I submitted 55 requests for interviews, primarily via email and using the social media website LinkedIn. The names of five of the contacted individuals were suggested by other interviewees (i.e., snowballing). Out of the total number of interviews requested, five subjects declined to be interviewed or said they were unavailable, while ten did not reply. As a result, the total number of conducted interviews was 40.

Format: All the interviews were semi-structured, with a list of questions prepared in advance to guide the discussion. The questions were tailored to each category of individuals. Given that a majority of the interviewees requested confidentiality when it came to the interview contents, the recording method used was the drafting of notes taken during the discussion and supplementary notes written within two hours of the meeting. As explained in the introduction, the interviewees are referred to by codes.

Saturation and compensation strategies: Saturation was reached across all interview categories except for Category 7 (trade unions and social partners), which was partly relevant primarily to the case study conducted in the second paper of the

dissertation. To compensate for the lack of interview data for this category, the analysis in the second paper relied on public statements by these actors and existing academic work on their perspectives on the subject matter. While I do not have complete certainty about these actors' views, I believe the convergence of the information obtained from other actors and the saturation reached in all the other categories help reduce the potential bias that might arise from the lack of interviews for Category 7.

Country/Institution	Name	Position	Category	Date	Type	Length
Portugal	Pedro Passos Coelho	Prime Minister (2011-2015)	1	20/03/2018	In person	1h30m
Portugal	Vitor Gaspar	Minister of Finance (2011-2013)	3	11/06/2019	In person	30m
Portugal	Alvaro Santos Pereira	Minister of Labor (2011-2013)	3	22/06/2021	Videoconference	30m
Portugal	Miguel Poiares Maduro	Minister for Regional Development (2013-2015)	3	19/10/2021	Videoconference	40m
Portugal	Anonymous	Government official	5	15/03/2018	In person	1h30m
Portugal	Pedro Martins	Secretary of State for Employment (2011-2013)	3	16/04/2021	Videoconference	1h
Portugal	Manuel Rodrigues	Secretary of State for Finance (2013-2015)	3	14/06/2020	Videoconference	1h20m
Greece	Antonis Samaras	Prime Minister of Greece (2012-2014)	1	05/12/2019	In person	1h
Greece	George Papaconstantinou	Minister of Finance (2009-2011), Minister for the Environment (2011-2012)	3	05/12/2019	In person	1h

Greece	Louka Katseli	Minister for the Economy (2009-2010), Minister for Labor (2010-2011)	3	03/12/2019	In person	1h
Greece	Evangelos Venizelos	Deputy Prime Minister (2011-2015) and Minister of Finance (2011-2012)	3	04/12/2019	In person	40m
Greece	Yannis Stournaras	Minister of Finance (2012-2014), Central Bank Governor (2014-present)	3	06/12/2019	In person	35m
Greece	Gikas Hardouvelis	Minister of Finance (2014-2015), Director of PM's Economic Office (2011-2012)	3	04/12/2019	In person	40m
Greece	Filippos Sachinidis	Deputy Minister of Finance (2009-2011), Alternate Minister of Finance (2011-2012), Minister of Finance (2012)	3	02/12/2019	In person	1h
Greece	Franciscos Koutentakis	Director of PM's Economic Office (2015) and General Secretary for Fiscal Policy (2015-2018)	3	02/12/2019	In person	45m

Greece	Panos Tsakloglou	Chair or Council of Economic Advisors (2012-2014)	5	05/12/2019	In person	1h
Greece	Riccardo Lambiris	CEO, Hellenic Republic Asset Development Fund (2017-2021)	6	16/03/2022	Videoconference	40m
Greece	Aris Xenofos	Executive Chairman of the Hellenic Republic Asset Development Fund (2017-2020)	6	05/12/2019	In person	40m
Greece	Anonymous	Government official	5	26/11/2018	In person	1h
Greece	George Pagoulatos	Senior Advisor to the Prime Minister and Director of Strategic Planning (2011-2012)	5	02/12/2019	In person	1h
Ireland	Michael Noonan	Minister for Finance (2011-2017)	3	07/07/2020	Phone call	30m
European Commission	Joaquin Almunia	European Commissioner for Economic and Financial Affairs (2004-2010) and Competition (2010-2014)	2	14/02/2020	In person	1h
European Commission	Anonymous	Commission official	4	28/10/2018	In person	1h
European Commission	Anonymous	Commission official	4	30/10/2018	In person	45m

European Commission	Anonymous	Commission official	4	15/10/2019	In person	1h30m
European Commission	Anonymous	Commission official	4	29/11/2018	In person	1h30m
European Commission	Anonymous	Commission official	4	30/11/2018	In person	1h
European Commission	Anonymous	Commission official	4	27/11/2018	In person	1h
International Monetary Fund	Anonymous	IMF official	4	13/06/2019	In person	1h
International Monetary Fund	Anonymous	IMF official	4	12/06/2019	In person	1h
International Monetary Fund	Anonymous	IMF official	4	30/06/2019	In person	45m
International Monetary Fund	Anonymous	IMF official	4	11/06/2019	In person	1h
International Monetary Fund	Anonymous	IMF official	4	12/06/2019	In person	1h
Eurogroup	Anonymous	Government official (Spain)	4	12/09/2019	In person	1h

European Trade Union Institute	Sotiria Theodoropoulou	Head of Unit, European Economic, Employment and Social Policies	8	16/10/2019	In person	1h
Journalist	Helena Garrido	Former director of Jornal de Negócios	8	20/09/2018	In person	1h
Journalist	Hugo Filipe Coelho	Former journalist at Diário de Notícias, author of "Resgatados"	8	25/10/2019	In person	1h
Journalist	Luis Reis Pires	Former journalist at Diário Económico, author of "Segredos de Estado"	8	21/03/2018	In person	1h
Journalist	Nick Malkoutzis	Journalist at Kathimerini and founder of Macropolis	8	04/12/2019	In person	40m
Journalist	Yannis Palaiologos	Journalist at Kathimerini and author of "The 13th Labour of Hercules"	8	05/12/2019	In person	1h

Annex 2

Privatizations in Greece – 2011-2018

Asset	Completion of transaction	Type of privatization
Rights for the use of the 900 MHz and 1800 MHz spectrum bands	2011	Infrastructure
License for the installation and operation of gaming machines (VLTs)	2011	Corporate
Extension of the contract for the conduct of lottery games between the Greek State and OPAP for ten years	2011	Corporate
NBG - ALPHA - Piraeus Bank shares	2012	Corporate
Sale of selected buildings abroad (London, Tashkent, Brussels)	2013	Land Development
Sale of the State Lotteries license	2013	Corporate
Sale of a 33% share in OPAP S.A.	2013	Corporate
OPAP S.A. shares	2013	Corporate
Lease for 90 years of the International Broadcasting Centre (IBC)	2013	Land Development
E-AUCTION I	2013	Land Development
Sale of selected buildings abroad (Dusseldorf)	2014	Land Development
Paliouri	2014	Land Development
Digital Dividend	2014	Infrastructure
Sale and leaseback of selected public buildings (28 properties)	2014	Land Development
E-AUCTION II	2015	Land Development
E-AUCTION III	2015	Land Development

Sale of selected buildings abroad (Belgrade)	2015	Land Development
Xenia Hotel Skiathos	2015	Land Development
Agios Ioannis Sithonias property	2015	Land Development
Mutual Horse Race Betting	2015	Infrastructure
E-AUCTION IV	2015	Land Development
Sale of selected buildings abroad (New York, Washington)	2016	Land Development
Sale of selected buildings abroad (Rome, Yerevan)	2016	Land Development
Sale of selected buildings abroad (Ljubljana)	2016	Land Development
Port of Piraeus (OLP) (51% + 16%)	2016	Infrastructure
E-AUCTION VI	2016	Land Development
Astir Palace Vouliagmeni	2016	Land Development
Property at Kassiopi, Corfu	2016	Land Development
Sale of 2 Airbus aircrafts	2016	Infrastructure
Modiano Market, Thessaloniki	2017	Land Development
E-AUCTION V	2017	Land Development
Regional Airports	2017	Infrastructure
TRAINOSE	2017	Infrastructure
ADMIE	2017	Corporate
E-AUCTION VII, VIII	2017	Land Development
Port of Thessaloniki (OLTH) 67%	2018	Infrastructure
EESSTY (ROSCO)	2018	Infrastructure
Hellenic Telecommunications Organisation (OTE) 5%	2018	Corporate
DESFA	2018	Infrastructure
Rights for the use of radio frequencies 2018-2035	2018	Infrastructure

Source: Eurobank EFG (2019)