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**The New Politics of Austerity: How the bailout  
enabled the Portuguese ministers to pass reforms they  
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## **The New Politics of Austerity: How the bailout enabled the Portuguese ministers to pass reforms they wanted all along.**

### **Abstract**

In April 2011, a caretaker Socialist government called in international lenders (the so-called troika, ECB, European Commission and IMF) to bail out Portugal. Following the elections, a centre-right coalition started to implement a series of severe austerity measures and social reforms, allegedly on behalf of the troika, provoking significant recession and social unrest. This paper first addresses the context and the conditions associated with the loans and the policies that followed. It also looks into the extent of the influence of international lenders in formulating these policies. Our main point is that the international lenders are by no way dictators within Portugal: as a matter of fact, the bailout has been frequently used by the current government to justify measures they wanted to pass all along but would not have been possible under normal circumstances.

**Keywords:** Troika; Portuguese bailout; debt crisis; Portugal; window of opportunity.

### **Introduction**

Following the banking collapse in the US and shortly after the beginning of the Greek debt crisis in the first quarter of 2010, Portugal was pin-pointed as a high-risk investment: demands for bonds issued by government shrank and the interest rate shot up. However, the PS (*Socialist Party*: centre-left) Prime Minister (PM) Sócrates kept insisting that the country would not have to be bailed out and negotiated a series of austerity measures in collaboration with the EU Commission. In March 2011, all opposition parties rejected the last government package, provoking Sócrates' resignation and the calling in of the international lenders (Troika: ECB, EU Commission and IMF) to bailout the country. In the national election of June 2011, a coalition composed of the

two right-wing parties, the PSD (*Social Democratic Party*: centre-right) and the CDS-PP (*Social and Democratic Centre Party – Partido Popular*: right), obtained an absolute majority and started to implement a series of painful austerity measures, allegedly conditioned by the international lenders, provoking recession and social unrest.

Since the bailout, there has been a very harsh debate in Portugal about the role that the international lenders play, and should play, in reforming the country. Many political actors and commentators argue that both the government and the ‘troika’ are going beyond their mandate by imposing the so-called “structural” reforms on the country, which severely reduce the welfare state and citizens’ social rights. Others point out that the intervention has had a positive influence in helping policy-makers pursue virtuous reforms that would have otherwise provoked strong opposition from its beneficiaries. Very little is known, however, about the extent of the actual influence of international lenders on these policies, and how the troika staff interacted with the Portuguese governments for this purpose.

This paper investigates the nature, causes and consequences of the policies triggered by the bailout for both citizens and their representatives. After presenting our theoretical framework, we review the context and the conditions associated with the loans, and the policies that followed. Second, we rely on in depth-interviews and examine whether the austerity policies had been imposed by the troika on a reluctant government; or alternatively, whether there is congruence between these policies and the government’s preferences.

Using the (relatively scarce) literature about this type of phenomena, our main argument is that the policies – especially structural policies – are by no way a diktat imposed from above on helpless governments. Government – especially the current right-wing one –

uses the troika as a window of opportunity to pursue reforms that would have met tremendous opposition otherwise.

### **Framing the crisis and political actors' stances: Theory and hypotheses**

The measures in response to the Troika MoU are likely to provoke extreme policy change within a country, so as considerable discontent from large sectors of the public. In this section, we present the literature regarding the actual influence of international lenders on policy-makers in the designing of this kind of policies.

#### *Crisis and bailout as a 'window of opportunity'*

Under normal circumstances, government intending to pass deep-seated reforms are likely to meet resistance from public opinion, and in particular from those groups which are targeted by the reforms (Pierson 1994, 1996). As a consequence, institutions and policies are often kept alive even if they are clearly sub-optimal (Pierson 1996). However, exceptional circumstances might enable governments to proceed with reforms. For example, it is well known in theory how crises (such as disasters or political scandals) can be 'exploited' (Boin et al, 2009). When faced with a severe crisis, political leaders/party leaders and their contenders may enter into a "policy game" in which the advocates of policy change (either incremental or paradigmatic) interact with those defending the status-quo (that either resist or contain policy change). As such, the current crisis opens window of opportunities for networks of reformers to push their preferred policies forward (Birkland 1997, 2006; Baumgartner and Jones 1993, 2002; Sabatier 1988; 't Hart 2009).

The 'window of opportunity' opened by the crisis might be capitalized by the governments. As 't Hart (2009) notes: 'While economic crises might limit governments' budgets, they also allow policymakers greater scope to implement reforms that would otherwise be met with fervent opposition' (see also Rodrik 1996). As economic crises are often global (undoubtedly true in the case of the current crisis), this move part of the

policy-making to international arenas where domestic opposition forces are not represented (t Hart 2009). In that sense, negotiations are a two-level game, in which government can obtain deals that suit them and which their domestic groups would never have accepted in the absence of international negotiations (Putnam 1988).

This literature relates to the one which looks at how IMF conditions might be used by government to carry out reforms that would have been rejected otherwise. It is known that any government facing balance-of-payments difficulties and requesting the IMF a loan has to accept the latter's conditions (generally reducing deficit, lowering domestic demands for exports and making the labour market more flexible). Conventional wisdom holds that the IMF uses conditionality to force governments to accept these reforms. Governments, it is assumed, do not want conditions to be imposed upon them and the IMF is therefore intervening in a way that infringes on a country's national sovereignty (Fischer 1999). For example, Gorjão (2012) notes for Portugal that: 'Ever since the international Troika (...) there has really been no question as to who would dictate the pace and developments of the Portuguese economy in the next few years. For all intents and purposes, Portugal was placed in an inescapable straightjacket by a series of rigorous obligations with which it was forced to comply to the letter' (Gorjão 2012).

However, this conventional view has been challenged by several authors. To start with, the IMF itself has long insisted on the importance of 'ownership', i.e., the interest of a country in pursuing reforms independently of any incentives provided by lenders (Drazen 2002). However, this official IMF view has some ambiguity given that conditionality would not be necessary if a country was absolutely committed to pursuing reforms. Many authors resolve this ambiguity by stressing the fact that governments sometimes use the outside pressure of the IMF to make necessary reforms while avoiding the unpopularity associated with them (Remmer, 1986; Edwards and Santaella, 1993: 425; Vaubel, 1986: 45). A similar (but more elaborated) argument is that the IMF

enables government to pass reforms they wanted all along but could not pass given the opposition of veto players within the country (Putnam, 1988: 457; Vreeland 2004; Drazen, 2002).

As a matter of fact, executives enter into IMF programs unilaterally: the approval of potential opponents to IMF policies or “veto players” (such as the legislature in a presidential system or a coalition partner in a parliamentary system) is not required. While the approval of these veto players may be required for policy change, failure to enact the changes might be more costly for the veto players once the country has entered into the IMF arrangement. This is because ‘rejection of reform is not merely a rejection of the executive, but also a rejection of the IMF. (...) These increased costs may lead veto players to approve of policy changes that they otherwise would have opposed’ (Vreeland 2004: 2).

However, as noted by Pop-Eleches (2009), the way in which the government's partisan policy preferences compare to the orthodox economic policy requirements of IMF conditionality is important, since the ideological costs of compliance are likely to be much greater for leftist governments than for pro-market politicians.

Following this literature, we argue that governing parties (in our case especially the PSD which shifted significantly towards the neoliberal right during the 2011 electoral campaign, Magalhães, 2012), are using the crisis and the Troika MoU as an opportunity to push forward reforms that have little support among the population (Freire, 2009, 2013a). Thus, our first hypothesis (H1) is that some reforms taken after the international lenders' interventions correspond to government preferences. But we go even further to propose a second hypothesis (H2) that some policies included in the MoU were not demanded by international lenders but were inserted after requests of the governmental itself.

## **Data and methods**

We rely on two different types of data. First, to analyze both the context of the bailout and the austerity policies derived from it, we rely on content analyzes of mass media articles and official documents. Second, in order to examine how Troika interacted with the Portuguese governments to design austerity policies we rely on 28 qualitative interviews with key ministers and junior ministers, both from the current right-wing government and the previous socialist cabinet<sup>1</sup> that were fielded in January - March 2013.

## **Bail out: a history**

After the fall of the Lehman Brothers in September 2008, there was a dramatic slow-down in the Portuguese economy. Exchange devaluation was not an option (unlike in the previous debt crises in the 1970s and 1980s), and the original approach taken by the first Sócrates' government (PS - majoritarian: 2005-2009) was fiscal expansion. These counter-cyclical policies were taken in coordination with the EU's initial neo-Keynesian approach to the crisis (European Commission 2008). A few months afterwards, however, the European Council urged the country to rapidly engage in policies aimed at medium-term fiscal consolidation (European Council 2009), thus forcing national government to give a huge U-turn in their expansionary policies, taking back what they had just given.

In April 2010, the Greek government asked for financial assistance from the EU to avoid bankruptcy, while the Portuguese government interest rates soared to their highest level since entry into the Euro. As the incumbent PS had lost the absolute majority in parliament, in the September 2009 general elections, the new minority government sought several times the opposition support (PSD) to pass budgetary measures. For about one year, it won its cause, and was thus able to get the budget 2010

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<sup>1</sup> face-to-face in-depth interviews of around 45 minutes each, 10 with past government officials, 18 with current government officials.

approved, so as three different versions of the Stability and Growth programmes (SGP) that should be delivered to the EU.

Such a cycle would eventually come to an end in early 2011. With the 10-year bond yields consistently above 7 per cent, the government was forced to negotiate a fourth austerity package with the EU. While there was no formal need to approve it in Parliament, Sócrates declared he would resign if the opposition proposed a successful resolution against the SGP IV in Parliament. Despite the pressure of new rating downgrades, a freshly re-elected president of the Republic did not take action to rescue the plan from rejection in Parliament (Freire, 2013a, 2013b). The PSD voted against it and the Prime Minister immediately resigned. In the aftermath of these events, the caretaker government had no choice but to ask for the bailout on April 6, at the beginning of the electoral campaign.

While the main interlocutor of the troika was the caretaker government, the troika also regularly consulted the two centre-right parties. By contrast, the radical left parties claimed that the bailout was undemocratic and unnecessary and refused to discuss with the troika. As a result, the memorandum of understanding (MoU) was signed in May by the lenders and the three mainstream parties: PS, PSD and CDS-PP. The negotiations finished in May, 2011, for 2011-2014. The bail out covered € 78 billion, two thirds of which to be financed by the EU, and the final third by the IMF. It foresaw action on three fronts. First, actions were planned in order to reduce the gross public deficit-to-GDP ratio down from 5.9% in 2011 to 3% in 2013. The measures (broadly based on the SGP IV) included, on the expenditure side: decrease in administration operating expenditures and government wages (through wage and promotion freezes and a gradual reduction in staff); cuts in social transfers (in unemployment benefits, pensions over 1500 euros, etc.); freeze of all other social outlays; increase in fees to access public services (in hospitals, in the courts, in public highways) and the increase of school's class sizes at the



primary and secondary levels. On the revenue side, efforts consisted mainly on the rise of taxes (VAT, corporate and personal income taxes). A second central objective of the MoU was to safeguard the financial sector deleveraging and to strengthen capitalization of the banks; allocating in total 27.2% of GDP to the banking system.

Third, the program contained deep structural reforms in three areas: First, policies to enhance flexibility and firm competitiveness, with measures such as an important reduction of severance payments; more flexibility in firing and in working time arrangements and a shift in the tax burden from production to consumption. Second, objectives were set to increase competition out of protected sectors. For example, the programs targeted the further liberalisation of the electricity and gas markets, of the railway and of the telecommunication and postal sectors; and promised a revision of the competition law. Third, a reform of the Judicial system was planned, including new court management models, procedural simplification, specialized courts, wider use of information technology, and alternative dispute resolution. It has to be noted, however, that despite their harshness, the program included some measures to protect the poorest segments of the population, for example the protection of salaries or pensions for income below a certain amount or the lowering of the minimum duration of contribution in order to get unemployment benefits.

At the June 2011 general elections, the right-wing parties obtained an absolute majority of votes and seats and, as the head of the PSD, Passos Coelho, became the new PM. The government started right a way to implement the program, and has been receiving every semester the visit of the Troika, which had the responsibility of assessing compliance with the MoU. At each visit eight significant revisions to the memoranda were agreed on (until October 2013). In these, the lenders noted the progress made as regards the initial objectives and the ones still to be made. While the results for deficit reduction have been disappointing, a greater source of satisfaction for the IMF/ EU was

the shrinking of the current external account deficit: to around 3 percent of GDP in 2012 from nearly 10 percent just two years ago. As noted recently by Ricardo Cabral, this extremely rapid fall in imports ‘is a stark indicator of the size of the shock the Portuguese economy is being subjected’ (in Monastitiotis et al. 2013: 30). Also, the troika repetitively claimed satisfaction regarding the advance of structural reforms: according to the lenders Portuguese authorities had been ‘exemplary’ in their application of the MoU.

Interestingly for our purpose, each of these revisions also included a specification into details of the existing measures, so as several new ones. The main reason presented to the public for these new measures is the difficulty, given the very fast increase of unemployment (that reached an all-time high of 18 percent in May 2013), and the decline of economic growth, to decrease public deficit and debt according to the initial objectives. Many of these measures are aimed to further increase revenue and decrease expenditures, those being necessary steps even though the government had received twice one extra year to meet the deficit reduction of 3%. As regards revenue, taxes had been increased, mainly those on income and goods and services. On the expenditure side, cash social transfer – such as the wages for public employees and for pensioners were considerably reduced (while the initial memorandum mentioned only a freeze of salaries and promotions of public employees), very considerable savings had been made in the Health and Education sector and many investment were cuts. It should be underlined that most of these cuts in salaries, pensions and the Welfare State were well above the original MoU prescriptions (Abreu *et al*, 2013), which were the ones that framed voters’ choices in the 2011 elections. Moreover, the additional memoranda also included totally new structural reforms, such as a new law on licensing.

Three important observations emerge from this section. First, there is a striking discrepancy between, on the one hand, the satisfaction of the international lenders as regards the Portuguese compliance with the program and, on the other, the feeling of the

population which saw its life style deteriorate to the bottom (Freire, 2013a, 2013b; see also Abreu et al, 2013). Second, we should note the specification into the detail, and even the addition of new and very significant measures in the seven amendments of the MoU until May 2013. This led to many people (political commentators, opposition parties, unions, etc.) to argue that the government is governing well beyond the political mandate they received in the 2011 elections and that followed the first version of MoU (Freire, 2013a, 2013b).

Also striking is the relatively easiness, at least until recently, with which the government managed to pass these extremely ambitious reforms. Indeed, at least until September 2012, and with a few exceptions for that period, protests had been relatively modest in Portugal and most of the measures had been passed with the abstention of the Socialist Party (De Giorgi et al. 2013). As a matter of fact, the few actors which managed to force the government to step back were: (i) one huge mass demonstration (ii) the coalition partner CDS-PP and (iii) the Constitutional Court (TC). As regard the former, in September 2012, a replacement of social contributions to employers by those of workers (a financially neutral move that would decrease employees' salaries and increase firms' profit) was proposed by the Prime Minister. In parallel with contestation from both unions and employers to the measure, and with huge mass demonstrations against the proposal (in September 15, 2012: around 1,5 million people went to the streets in several Portuguese cities), the CDS-PP and its leader (the vice Prime Minister, Paulo Portas) declared to be against the measure. Finally, the proposal was withdrawn. An additional, extremely important, veto player was undoubtedly the TC which vetoed many important laws or decrees, such as the decreases of wages of public servants and pensioners.

**International actors: The extent of the influence of the EU (before the bail out)**

## **and the international lenders (after it) on the definition of austerity policies**

If governments wish to use the international lenders as a way to pass reforms they desire while bypassing domestic opponents, they obviously will not declare it publicly. Therefore, in order to test our first and second hypothesis, we shall rely on interviews in order to get some insight of the negotiations. The first author practiced 28 face-to-face interviews with key policy-makers who participated in the negotiations of the MoU (both initial version and revisions). Those were promised complete anonymity, and asked questions such as: to what extent do you agree / disagree with the policies included in the MoU? To what extent are these reforms similar to what you/your party believe is good for the country? Can you give me examples of points of disagreements and of agreements? Did you sometimes specifically ask for a particular reform to be included in the MoU, even though it was not specifically required by the troika? We got a very high response rate (around 80%), as well as what seemed to be very honest answers. Below, we summarize the main findings of these interviews.

### *Influence of the Commission before the bail out and reasons behind calling into IMF*

When asked about the influence of the EU on socioeconomic decision-making before the bailout, interviewees all stressed the gradual increase in Commission monitoring of their budget. Already in 2008, each government of the euro-zone had to present its draft budget in April to the EC (preceding parliamentary vote in September). This draft was then analyzed by experts of the Commission who spotted errors, gaps or anything likely to increase deficit or debt more than was allowed. In 2009, the EC, following the European Council guidelines, requested government to take measures to promote economic growth and employment, thus allowing them to deviate from the strict budgetary objectives. One year later, however, it required a U-turn towards sharp austerity and deficit reduction, at the same time giving much more specific guidelines to governments as regard their budget. As a former minister noted: from 2010/2011 in

particular, the constraints of the EU were much stronger , requiring detailed information on the measures that we intended to adopt (whether to reduce expenditure or to increase revenue) but more than that creating a real bond, commitment from the government to actually adopt these measures’.

The fourth Stability and Growth Pact, in particular, was prepared in very close collaboration with the EU Commission. The objective, according to the interviewees, was to avoid rejection or critics at a later stage, and thus maximizing the chances of avoiding a bail out. Following a similar goal, the Prime Minister prepared with Helena de André an ambitious reform of the Labor code («the pact for employment») in collaboration with the social partners, to boost competition. As we know, the SGP IV was rejected in Parliament. When interviewed, the current ministers recognized that they then knew that this rejection would call in the international lenders (but also provoke elections that they felt were likely to win). This contrast gives some support to Pop-Eleches’s argument that, the more a government is ideologically close to the IMF orthodoxy, the more likely it would be to call it in.

#### *Negotiations of the initial MoU*

After the failure in Parliament of the last SGP (IV), the IMF/EU were brought in and negotiations for the bailout started. At this point, key participants recognized that the ‘rapport de force’ has changed; and that their margin of negotiation was smaller. As a former minister noted: ‘it is always different (...) negotiating when you are trying to reach an agreement which, at the limit may not happen (...) from when you are negotiating with the Troika after requesting a bailout. Another one gives the case of freezing the minimum wage as an example: ‘the ECB and EC wanted us to include a reference in the to the freezing of the national minimum wage. The government refused to do several times and ultimately it was not included in the SGP 4. When the Troika MoU arrived, (...)

they said there was no point discussing it, they told us to write the freezing of the minimum wage or they would not give us financing'. In addition to the minimum wage, the government had to cede to the troika on issues like the amount of the loan (a further 10 million were requested) and the timing of the privatization (the government only wanted to sell when the market picked up).

However, none of the participants saw the negotiation as a diktat from the international lenders but rather as a continuous dialogue, in which the diagnosis of the problems, the objectives to reach, and the best ways to get there were agreed upon. Interviewees stressed the importance of benchmarking (i.e. comparing Portugal to other countries) for the problem diagnosis, but also the fact that, once those problems were identified, the government was the one which was expected to come up with possible solutions. An agent from IMF for example notes: 'It's up to the government to come up with a plan. (...) It's not like the Troika comes with a list of things and says that they have to do these things and then get the money. It doesn't make sense because partly only the government knows how things work.'

Moreover, the government had also been able in many cases to get its own way in case of conflict. For example, it successfully opposed cuts in public servants' salaries and in lower pensions, the decrease of unemployment benefits for existing contracts only, firing in the public sector, or the possibility to fire without fair cause. As a former secretary of state told us: 'Even if a country is in this situation, terrible and without choice, the Troika did not play against us. It was a very intelligent negotiation, in which we tried to find out what would be the best for the country'.

Similarly, another PS top official noted about health reform: 'I would say that the large majority of measures were negotiated, or proposed, by the government itself. Most of what is in the Troika's memorandum on health is what was in the SGP 4. There weren't many changes (...) and in two meetings and the exchange of documents we very

easily managed to agree with the Troika without any problems’.

Very interestingly, a minister noted the way in which the main opposition party pushed for reforms that the PS government successfully managed to put out of the table: ‘We knew when they had been negotiating with the PSD, because when we had an agreement, two or three days after the issue was back again on the negotiation table; more rigid than what we had agreed (...) for example, regarding TSU, it was proposed by the Troika, we argued, explained which were the disadvantages, and the troika accepted. Two days after, they put back again the question on the table, and we had to negotiate again in more difficult terms because the PSD went in favor of it (...) that is why the PSD signed the program, it had an influence on it’. There was thus, congruence between the PSD and the CDS orthodoxy and the initial memorandum. For example, a current secretary notes the following for the energy sector: In this case the Troika is in total agreement with what the government thinks; in other words, even without the Troika, the government would think that these measures should be taken to cut costs, and so our interests are in line with each other, which can be good because the measures then really move forward and overcome any resistance’. When asked about whether the measures negotiated in the initial Memorandum from what their policy preferences were, a majority of ministers answered by the negative.

#### *Additional Memoranda*

Interviews with ministers from the current government also support the two hypotheses stated above, in the sense that many ministers saw the intervention as a window of opportunity to push reforms they wanted all along and even often required the international lenders to insert some items in the document to get reforms easier. To start with, all ministers from the current government saw no important differences between the MoU and their own policy preferences. Moreover, and in clear agreement with H2, many ministers or junior ministers of the current government presented several

examples of measures to be introduced in the revision of the MoU in order to circumvent opposition to it. According to the interviewees, this has been the case, for example, for the liberalization of several sectors of the economy; for the shift from collective negotiation with unions to negotiations with commission of workers for a specific industry/corporation, for the quick judicial process for urban rehabilitation (opposed by lawyers), and for the recent new laws on licensing. A current junior minister stated: ‘Most of the Troika’s memorandum are things the government wanted to do, most of them. The policy of this government (...) is to increase competitiveness by cutting salaries and the sooner we are able to stabilize the economy, the sooner growth will begin, so all this business of cutting salaries, the sharp rise in taxes and in effect the reduction of income, the increase in the cost of electricity, doing away with various things that the public companies did to provide good services because they are not profitable, and so on, all this was in the MoU and it wasn’t in the first version. It is there because it is on the government’s agenda and they know they are in stronger position to accomplish this if they have a state obligation to do so.’ Another ministers, also from the current government, when asked if a minister would have done something very different without intervention of the Troika answered: ‘No, probably no... there is here a window of opportunity that allows to bypass the resistance of stakeholders, professions, industries, pharmacies, of our administration, to make reforms that were necessary. For sure, these reforms were understood as necessary within the country.’ In our view, this evidence enables us to confirm H1 and H2.

## **Conclusions**

In this present paper, we aimed to analyse the nature and consequences of the Portuguese EU/IMF bailout in 2011. We first expected a high congruence between the measures passed after the bailout and the preferences of the government (especially the current centre-right one). This is because, we argue, crisis and particularly the troika



intervention opened a window of opportunity enabling governments to bypass domestic opposition and to pass measures that they wanted all along. Bearing on an analysis of official documents, mass media accounts and 28 in-depth interviews with ministers and junior ministers (of the current and of the previous governments), we found strong support for this argument. First, Ministers and their Juniors, especially those from the centre-right, generally acknowledge congruence between the conditions of the initial MoU with their own favourite policies. Moreover, many ministers from the current government acknowledged that, while revising the MoU, they specify existing measures, or even include new ones, with the specific purpose of decreasing opposition on policies that they favoured all along. In other words, ministers from the centre right used the intervention as a clear window of opportunity so as to induce a 'paradigm policy shift' towards their favourite neo-liberal stances.

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