**From Lever to Club? Comparing Conditionality in EU Enlargement and the Eurozone Crisis**

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How should scholars understand the evolution of EU instruments for crisis management in the Eurozone? This article focuses on conditionality and, in particular, three less-studied dimensions of this broader question about EU instruments: first, the way in which instruments for crisis management in the Euro may have been influenced by the prior decade’s largely happy experiences with conditionality in the context of EU enlargement between about 2000-2007; second, the satisfying (if misleading) EU experience with macroeconomic conditionality in non-Eurozone states from the outset of the global financial crisis; and third the largely disappointing results of conditional instruments and the policies the EU has helped bring about in Southern Europe since 2010.

We argue that despite the promise of conditional instruments in earlier episodes, further EU reliance on conditional policies has not brought the positive outcomes the main European institutions—here the Council, Commission, and ECB—had hoped for. Thus, our paper joins a chorus of recent voices in suggesting the EU needs to try something new (Matthijs and Blyth 2015; Chalmers, Jachtenfuchs and Joerges 2015; Börzel 2016). While the nature of that “something new” is beyond the scope of this paper, we hope to offer a diagnosis of one of the little-seen but quite important roots of EU conditionality. To that end, we define conditionality as promises by international organizations (IO) to provide benefits—including membership—to states in exchange for those states enacting specific policy changes spelled out by the IO (Steunenberg and Dimitrova 2007, 3).

Our basic argument is that the EU—in particular, the Commission—is taking a legitimate policy tool in what may ultimately prove to be illegitimate directions. Conditionality is a new tool in the EU’s tool kit, having been most prominent since the accession of ten new member states in 2004 and 2007. In subsequent years, it was used in a somewhat different form “against” Romania and Bulgaria even after they became members. Since 2008, it has then morphed into an increasingly widely-used instrument vis-à-vis the Southern European member states, particularly Greece, Spain, and Portugal (as well as Ireland) and, for a much shorter period, on Latvia, Hungary and Romania, which also needed bailout programs. We document this evolution, summarize the changes in conditional instruments and show the limitations of conditionality as a substantive policy during the Eurocrisis such that conditionality is ultimately downgraded and substantially eclipsed by a new monetary policy regime known as quantitative easing.[[1]](#footnote-1)

Our main point is that the stronger the form of conditionality the EU has tried, the less it has worked. Digging deeper and deeper into the most sensitive policy domains of its members has not lead to macroeconomic stabilization in the way the EU has hoped. This is not to deny the political importance of conditionality in mollifying angry voters in Northern European creditor states (Matthijs and McNamara 2015). Given the way that the Eurocrisis was framed in Germany, there is little chance that German politicians would have lent or given assistance without some form of conditionality (Brunnermeier, James, and Landau 2017; Jacoby 2015).

The more recent disappointments with conditionality that we document below may well be linked to a tendency to overattribute success to conditionality in earlier periods. Indeed, while conditionality was an important and useful tool during the enlargement period, it was hardly the only tool the EU wielded during those negotiations, nor did it always succeed (Kelley 2006). While conditionality did play an important role in preparations for the 2004 enlargement, the EU’s success always depended on much more than conditionality. For example, Bruszt and Langbein (2015) show that the EU used a range of other informal instruments to help develop CEE states for membership (see also Bruszt and Vuchov 2017). Thus, conditionality was not the only or even main tool used by the EU during enlargement. Yet EU conditionality soon thereafter was deployed quite aggressively on troubled non-Eurozone EU member states in that same region. And, the EU approach to Southern Europe appears to have elevated the conditionality tool to an even more central place in its policy mix between the onset of the Eurocrisis in 2010 and the start of the ECB’s quantitative easing in March 2015.

To an extent, the scholarly literature also seems to have overattributed success to conditionality (Jacoby 2006). For example, many sophisticated works of scholarship on the CEE region—eg. Vachudova 2005—have been subsequently stylized and simplified in citations, such that the EU role is reduced to “active leverage” or conditionality. Meanwhile, Vachudova’s claims about “passive leverage” and indeed a range of other instruments are downplayed or even forgotten. To be sure, Commission officials are generally well aware of the shortcomings of their conditionality instruments and have worried about the ineffectiveness of conditionality tools against backsliding of 2004 entrants like Hungary (Kelemen 2017; Scheppele 2015); meanwhile, others see the endemic corruption of 2007 members, and still others emphasize the essential irrelevance of conditionality for some states in the Western Balkans (Börzel 2011). And yet notwithstanding ambivalence at the EU level about conditionality tools, we see a veritable explosion of these instruments being used on existing member states. Greer (2014) establishes that these EU-imposed conditions have strong affinities with IMF conditions familiar from long experience.[[2]](#footnote-2)

**Stylized differences: Conditionality across two periods**

A stylized summary of the differences in conditionality in the two periods appears in Table 1. Conditionality toward CEE states in the late 1990s and early 2000s (top row) was aimed at ensuring a certain level of institutional convergence on EU-15 practices. Single Market regulations have direct effect and often required little explicit legislative work by the candidate states, although compliance often required setting up entirely new state institutions in domains from agriculture to consumer protection to energy and transportation. EU directives, of course, also required a legislative product and often also required new bodies to be established or heavily reformed. If we focus on the 35 policy “chapters” affected by the Commission’s screening process, many were surely very important—free movement, energy, environment, public procurement. But almost none of them involved the most sensitive core state functions of citizenship, defense and foreign policy, or basic economic choices about fiscal, social, and labor market policy.[[3]](#footnote-3) True, all CEE states were obliged to commit to future membership in the EMU. Yet no monetary conditionality had immediate effects, as evidenced by the wide range of policies pursued by the CEE states (Bohle and Jacoby 2017). At the same time, conditional measures were flanked with many policies of a non conditional nature, including trade access, FDI promotion, and promoting the extension of the value chains of West European MNCs (Brustz and Vukov 2017). Finally, there could be little doubt the EU controlled the central reward promised through conditionality, namely full membership in the EU. In that sense, the conditionality was likely to be credible.

Table 1: Stylized differences in the two phases of EU conditionality

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | Kind of states affected | Policy areas affected | EU measures flanking conditionality | Does the EU control the reward? |
| Conditionality in CEE during early 2000s | Candidate states with a membership perspective | Primarily non-core state functions | Trade access, FDI promotion, value-chain incorporation | Yes, the central reward is EU membership |
| Conditionality in CEE and SE in crisis period | Member states with liquidity crises requiring assistance | Often core state functions, (fiscal, public employment, labor market, social policy) | Emergency liquidity assistance of various kinds | No, the central reward is the return of economic growth or lower debt/GDP ratios |

More recent crisis-era conditionality in both CEE (Latvia, Romania and Hungary all had Troika programs) and Southern Europe has had a quite different character.[[4]](#footnote-4) First, the affected states are all EU members, including longtime members in Iberia and indeed one founding EC member in Italy. Second, conditionality here is very much focused on core state functions in fiscal, labor market, and social policy domains—all areas of traditional member state prerogative. Third, the flanking measures have been both narrower and deeper. On the one hand, the rewards for the conditioned behavior have been almost exclusively monetary, primarily in the form of liquidity assistance for banks or programs to purchase the bonds of states. At the same time, the amount of money provided by or with the help of the European institutions is far higher than what was available in the pre-accession programs.[[5]](#footnote-5) Yet despite the vast sums of money spent in crisis states, the EU is only in a position to reward crisis state policies with the promised liquidity. It cannot, of course, give them stable fiscal balances, let alone economic growth. Simply put, happy economic outcomes are not the EU’s to bestow, and additional liquidity—though badly needed—cannot be linked to a concrete outcome in quite the same way EU membership could.[[6]](#footnote-6)

Thus, despite some commonality in the instruments developed and deployed in the two periods, there are significant differences in important scope conditions. The next section briefly recaps the development of conditional instruments in the EU before turning to a summary of the ways in which conditionality has been deployed after the 2008 global financial crisis and 2010 Eurocrisis.

**The EU discovers conditionality: The 2004 and 2007 enlargements**

Historically, the EC/EU has made very little use of conditionality (Grabbe 1999). For the most part, the EC/EU have worked according to a legal logic, in which the costs and benefits of both intergovernmental and supranational modes of policy making were shared by all member states. The famous “Community Method” had an ultimate threat of coercion in the authority of the European Court of Justice. But the Community Method was a joint decision making process with no quid pro quo for compliance. At most, one might see proto-conditionality in the policy area of structural funds, where member states received variable access to investment funds and only if they fulfilled an increasingly complex set of requirements (Hooghe 1996). Conditionality was mainly a minor EU tool in its dealings with third countries (Smith 2003). When the EU made emergency loans to member states in the 1990s, no conditionality was practiced (though interest was charged). Even EU enlargement waves through the mid-1990s required prospective members to adopt the EU’s *acquis* but not to undertake any of the wide range of special steps required of CEE members only a few years later (Steunenberg and Dimitrova 2007, 3-4).

This changed with the Council’s decision to shape a “membership perspective” for states in the former Eastern Block. One aspect of this pre-enlargement process was the translation of the large corpus of primary and secondary legislation of the Union into a set of institutional targets for the ten states then actively pursuing membership (Grabbe 1999). These efforts to promote legal, institutional, and behavioral reform went well beyond those made in prior (much smaller) waves of enlargement. A number of tools intimately related to conditionality were developed, primarily by the Commission. These includes aid instruments (Phare) that themselves involved conditionality, plus the screening exercise, national programs for the adoption of the acquis communautaire, and the Commission’s annual report series on each prospective member state (Jacoby 2004).

In addition to conditionality, however, the EU also made available what Bruszt and Vukov (2017) (following Bruszt and McDermott 2012) call “multiplex” assistance programs that gave the EU-prospective member state relationship a joint problem-solving dimension. As noted earlier, these programs were also flanked by foreign direct investment from private sources that saw the slow but substantial incorporation of the region into the production chains of firms headquartered in Western Europe (Timmer et al 2014). To be sure, these firms (and the states in which they were headquartered) kept a close watch on competitive conditions and often actively “managed” their own backyard in ways that were opposed by states in CEE (Jacoby 2010). Still, the important points are that EU conditionality was focused on one major goal (membership), generally targeted non-core state functions, and was flanked by both private and public initiatives that promoted the rise of CEE up the value chain.

**Crisis-era conditionality: from lever to club**

EU actors had many reasons to feel satisfied with their use of conditional tools, and there is evidence they did feel satisfied. First, all of the states subject to conditionality in the enlargement period were ultimately allowed to join the EU. Had this not been the case, second thoughts about conditionality might have registered sooner. Second, when the decision was taken to delay Bulgarian and Romanian accession by three years (when compared to the other then-candidate states), the Commission leaned even more heavily on conditional instruments in its overall policy mix. Indeed, the EU generated a new mechanism for Bulgaria and Romania that preserved elements of conditionality even after membership. Moreover, when the EU established an instrument for what came to be called the “Neighborhood,” there was a strong element of path-dependency in the instruments used (Kelley 2006b). To be sure, it soon became quite clear to the EU (and in the scholarly literature) that the lack of a membership perspective had made conditionality substantially less effective in the neighborhood (Lavenex and Schimmelfennig 2007). Still, the general consensus was that the EU’s use of conditional instruments had facilitated its engagement with Central and Eastern Europe.

This article’s aim is not to provide direct sociological evidence that conditional programs in the first period were necessarily very influential in setting up conditional programs in the second period. Certainly, every Directorate General inside the Commission was involved in enlargement through the legislative approximation and monitoring functions, so experience with conditionality was spread widely across the Commission’s relatively small staff. Moreover, DG ECFIN officials also learned about conditional instruments from their interactions with the IMF already with the outbreak of severe balance of payments problems in CEE in 2008.[[7]](#footnote-7)

Instead, our burden is to show that the nature of conditionality underwent a radical shift in focus and technique with the onset of the global financial crisis and Eurocrisis. Our argument is broadly consistent with Börzel’s view that the EU tried to manage the Eurocrisis as a “regulatory” matter, as regulatory politics was the classic locus of conditionality during enlargement (2016). Of course, a key difference is that the debtor countries of the periphery were already fully compliant EU members, and therefore none of the measures could be regarded as requirements for continued membership. Instead, the conditionality measures were measures that in many cases had already been recommended, for example through the Open Method of Coordination, but which could now be coercively imposed as the need for financial aid gave the EU institutions dramatically increased leverage. This gave a deeply invasive quality to the European institutions’ interventions in the organization of the economy and society, and brought them into deeply sensitive and normative areas of domestic politics in some member states, whilst others maintained a greater degree of independence.

The first EU member states to feel a new version of conditionality were Hungary, Latvia and Romania, three recent entrants who turned to the EU and the IMF to deal with severe balance of payments problems. Hungary achieved a $25 billion package, with roughly two thirds coming from the IMF and a third from the EU.[[8]](#footnote-8) That same year, Latvia took around $5 billion (out of more than $7 billion allocated) from the IMF and EU, while Romania took around $20 billion in bailouts in March 2009 (for details, see Henning 2017). Procedurally, the Commission was part of a process with the IMF that seemed to restore current account balance
without destroying state budgets and bringing CEE countries back towards a
growth perspective.[[9]](#footnote-9) Indeed, Hungary regained market access in less than year, placing euro-denominated government bonds as early as July 2009 (Carare 2009). Latvia’s program lasted somewhat longer but also resulted in lower than anticipated disbursements and earlier repayment, which many analysts linked explicitly to its fiscal tightening (Aslund 2010).[[10]](#footnote-10) Substantively, the essentially liberal reform path reinforced the market fundamentalism that informed views at the Commission (and also in Berlin).

Thus, it is likely the Commission entered the post-2010 era with Southern Europe overconfident in both its tools and its prescriptions. To see why, it is critical to note the ways in which the CEE cases of macroeconomic crisis were different from those that would soon break out in Southern Europe. First, the CEE cases came close on the heels of the meltdown in US and UK financial markets and were properly diagnosed as financial and banking crisis and not one of state debt (Blyth 2016). Second, their resolution went hand in hand with massive ongoing investment spending in the region (especially by German auto manufactures) (Timms et al 2014). Third, the CEE crisis states’ non-membership in EMU meant they could devalue their currencies. And while Latvia chose not to devalue, the Hungarian forint dropped substantially. Fourth, with the partial exception of Latvia, the banking bailout bills were paid mostly by outsiders (e.g., Nordic, Austrian, and Italian banks). Finally, Latvia and Romania made substantial use of outmigration to help adjust. As the following sections show, the Southern cases are different on every dimension, with much worse outcomes and deeper implications for the European project.

**Conditionality and Monetary Union: The Maastricht Blueprint**

Although all the countries subject to conditionality under the various financial assistance arrangements were already EU member states, participation in European Monetary Union had itself been conditional on success in meeting a series of “convergence criteria” established by the Maastricht Treaty (Dyson and Featherstone 1999). This previous experience of conditionality had two salient features which may have influenced subsequent choices. First, the success of some of the economically weaker member states in achieving the quite demanding requirements of monetary union established a very positive precedent which policy-makers could draw on. The apparent success of national policy-makers in persuading voters to accept politically challenging reforms and stringent fiscal and monetary policies were celebrated as an example of how external pressures could force governments to adopt the right policies, overcoming domestic opposition (Dyson and Featherstone 1996, Ferrera and Gualmini 2010).

A second, less positive feature was the evidence, already visible at the time but even clearer in retrospect, of “gaming” the process so as to meet the criteria with the minimum of real change. In this the Southern countries were assisted by the difficulty Germany and France themselves faced in complying, which encouraged a more lax interpretation of the criteria in order to allow the process to go ahead (de Grauwe 2010). It subsequently became apparent that accounting tricks of various kinds had also been deployed in order to reduce borrowing figures artificially, most notably by Greece, whose resort to fiscal sleights of hand became apparent once the financial crisis began (European Commission 2010). The resulting mistrust strongly reinforced the case for close supervision and invasive monitoring of member state governments.

The convergence criteria revealed an enthusiasm for external supervision and disciplining which was particularly present in Germany and other Northern European core countries. Political leaders and voters in these states were sceptical of pooling monetary sovereignty with member states in the South with a history of high inflation, weak fiscal policy and debt default. The architecture of EMU was therefore designed to monitor the fiscal behaviour of participating states, both as political cover to reassure Northern electorates that the euro would not expose them to excessive risks, and as a practical matter, to provide Northern governments with some degree of control over the new arrangements.

**Getting Serious: Greece and the Troika Takeover**

The sovereign debt crisis in the eurozone periphery began with Greece’s slide into insolvency in 2010. The €110 billion bailout agreed by the European Commission, the ECB and the IMF (the “Troika”) was the first move in the European response to the run on periphery debt, and therefore had to overcome a good deal of political resistance. European elites faced a difficult dilemma between avoiding contagion and creating moral hazard, and were constrained by rules established by the designers of the EMU that outlawed direct bailouts of indebted governments or debt monetarization, rules enshrined in Article 125 of the Lisbon Treaty. The response was to lend Greece the money, but on condition that it both implemented austerity measures to reduce its deficits, and introduced structural reforms to address some of the country’s most glaring weaknesses. By imposing harsh conditions on Greece, the potential moral hazard would be attenuated, and the more unpleasant the conditions, the more it would send a clear signal that bailouts would not be an easy option for profligate eurozone governments.

The 2010 conditionality measures in Greece included structural adjustments on fiscal policies, including the task to reduce the general deficit by 11 perfect of GDP over three years to 3 percent by 2014 (Henning 2011 and Henning 2017, 85, 261 Annex 1). This was done through the reduction of the 13th and 14th holiday payments for civil servants and cutting bonuses by a further 8 percent to save 1.1 billion euros in 2010 (Petrakis and Weeks 2010). These measures also included cutting public investment plan by 500 million euros. To raise revenue, there was an increase in the two main sales-tax rates to 23 percent (from 21 percent) and to 11 percent from 10 percent (Petrakis and Weeks 2010). Revenues also included an increase of 4 percent GDP through 2013 by raising taxes on luxury items, tobacco, and alcohol among other items (Henning 2011, 37). In other words, the Troika was dictating, in extremely detailed fashion, exactly how the axe was to fall in order to free up resources to pay Greece’s debts, drawing on the experience of the IMF’s structural adjustment programmes typically applied to developing countries (Greer 2014). According to the Memorandum of Agreement Greece agreed to consult the Troika before “modifying” any of these measures or “adopting new measures that may deviate from the goals of the programme” (IMF 2011).

Not only was the programme extremely invasive, it imposed a punitive degree of austerity on the Greek population. This harsh austerity was hard to justify in economic terms, given the recessionary and debt deflationary dynamics it unleashed (Blyth: 2013, Ch.2). The likely effects of this austerity were predicted at the time: internal documents subsequently revealed that senior IMF officials opposed the bailout package and predicted it would lead to a deep recession and further financial problems down the line (Wroughton et al 2015). The Fund’s projections for Greek growth turned out to be embarrassingly over-optimistic, with each new agreement accompanied by a downgrading of expected GDP (Waldman 2015).

The headline points of the Economic Adjustment Programme for Greece were the fiscal measures, but underpinning the Commission’s analysis was a diagnosis of structural weaknesses in the Greek economy that needed to be addressed (European Commission 2010) The Programme used the language of structural reform and competitiveness, arguing that Greece “underperforms in many structural policy areas”, notably “rigid product and labour markets” which would “undermine the Greek economy’s capacity to adjust” (European Commission 2010, 6). These were areas that the Commission had already identified as problematic in the past (European Commission 2010, 13). The Programme also identified major failings in the operation of the Greek public administration and public financial management. In short, the Programme laid down an ambitious plan for the reform of the Greek state and economy, with a conditionality regime to make further disbursements of aid dependent on achieved agreed reform targets.

Despite it being based on “conservative assumptions” subsequent events proved this Programme so unsuccessful that a second Greek rescue package, amounting to €164.5 billion, was needed by late 2011 (European Commission 2010, 28). The Second Economic Adjustment Programme superseded the first one, and brought additional conditions, including in 2013 a cut in the minimum wage by 22 percent, a reduction in ULC of about 15 percent, a reduction in health-related expenditure by 1.1 billion Euros and 500 million in pensions and family allowances (Henning, 2017, 264). The second bailout was needed because of the sharper than expected collapse of Greek GDP in the wake of the austerity measures introduced, and the spiking of interest rates across the periphery leading to fears of contagion.

The Eurogroup, wary of the apparent failure to make sufficient progress after the first bailout, urged an increase in monitoring the Greek government, “(inviting) the Commission to significantly strengthen its Task Force for Greece, in particular through an enhanced and permanent presence on the ground in Greece, in order to bolster its capacity to provide and coordinate technical assistance” (Eurogroup 2012). Here, conditionality was complemented with attempts to establish increasingly invasive oversight and control. This included the demand to introduce into “the Greek legal framework a provision ensuring that priority is granted to debt servicing payments,” requiring constitutional change. In this example, conditionality tools extended to altering the fundamental law to (attempt to) prevent the Greek state spending money on its own citizens that could be spent on repaying international creditors. These moves reflected an increasing exasperation at the difficulties involved in getting Greece to meet the conditions of financial aid, difficulties due to both the political constraints facing Greek leaders, and the Greek government’s awareness of the lack of options facing European leaders fearful of the consequences of a Greek financial implosion.

The Greek bailouts are perhaps the sharpest case of the dilemmas of conditionality, and other programmes proved less difficult, but reveal similar tensions. The Irish bailout of 2011, worth €85 billion, required meeting a 3 per cent government deficit target by 2014, and to achieve this specifically demanded detailed cost cutting measures such as a public sector pay freeze, as well as stabilization measures for Irish banks and a one euro cut in the minimum wage. The Portuguese bailout of 2011 amounting to €78 billion contained measures to cut on 5 percent average public sector wages and wages and pensions to be frozen, with a reduction of civil servants at the central government by 1 percent in 2012 and 2013 (Henning, 2017, 126, 263). The measures amounted to spending reductions for 2012 and 2013, including cuts to pensions, of 3.4 percent of GDP, and revenue increases of 1.7 percent (Neuger and Reis 2011). Cypriot conditionality was similar to that of Greece and Portugal, involving a two per cent raise in the standard VAT rate to 19 percent by 2014, and a rise in the reduced rate from 8 to 9 percent, and public sector wage freezes (Griffiths and Todoulos 2015, 15).

As we can see, the interventions in member state policy were extremely detailed and extensive – in the cases of Ireland and Portugal around 400 distinct measures were recommended (Kincaid 2016: 32). And of course arrangements were set in place to monitor implementation involving frequent reporting to the IMF and quarterly reports of progress. These drew on the IMF’s extensive experience with financial assistance, necessary in part because of the urgency of putting together agreements and procedures, and the European institutions’ limited experience (Kincaid 2016: 30). The effect of this was to create an awkward mix of European governance and external intervention by an IO, the IMF, used to applying conditionality to developing countries.

The bailouts were a long way from being a technical challenge alone. On top of the difficulties of securing the financial stability of the Eurozone and avoiding a breakup of the monetary union, policy-makers also had a clear political purpose. "These countries can see that the path taken by Greece with the IMF is not an easy one. As a result they will do all they can to avoid this themselves," Angela Merkel told the *Bild am Sonntag* newspaper.[[11]](#footnote-11) This same point was made more forcefully in private meetings of European leaders. According to former US Secretary of Treasury Timothy Geithner’s memoirs, unnamed EU leaders took the view that, “we’re going to teach the Greeks a lesson. They are really terrible. They lied to us. They suck, and they were profligate and took advantage of the whole basic thing, and we’re going to crush them” (Geithner 2012). By adopting a hard line on financial aid, with painful and extensive conditions attached, European policy-makers were engaged in a political process which established a clear power relationship between the financially troubled member states and their creditors, notably Germany.

The Spanish bailout also illustrates clearly the political nature of European financial assistance in this period. Spain differed from the other countries in that financial difficulties came later and were limited to the supply of funds to backstop Spanish banks, rather than government borrowing, although the two were obviously connected. As a result, the major conditions attached to assistance focused on restructuring the Spanish financial sector, involving recapitalizations, changes to the governance of state-owned banks (cajas), the creation of a bad bank (Sareb) and an independent audit of the sector (European Commission 2012). Up to €100 billion, of which almost €40 billion were actually used. The key banks included in the reconstruction were Bankia (formerly Caja Madrid), Novagalicia Banco, Catalunya Banc and Banco de Valencia. Bankia said it would “lay off 6,000 employees, or 28 percent of its work force, and cut its branch network by 39 percent. The bank predicted it would return to profit next year and reach earnings of €1.5 billion ($1.9 billion) by 2015 (Minder and Kanter 2012).” Instead, Bankia remained on the state books in 2016, and the Spanish government had only recouped a small part of the outlay (Buck 2016).

Notwithstanding these difficulties, Spain was treated rather differently than the other bailout countries. The European Stability Mechanism boasted that “Spain is a good example of the success of ESM assistance programmes,” and is particularly proud of having managed the programme without the aid of the IMF (European Stability Mechanism 2018). Spain benefited from the measures taken by the ECB to ease funding pressures on Eurozone governments, but was also given special treatment due to the Eurogroup’s trust in the conservative Rajoy government, which had already pushed through a far-reaching liberalization of the labour market which had the effect of accelerating wage adjustment. The European institutions have tended to treat Spain similarly to Ireland, as a success story to contrast with the Greek debacle. Trusted member states, it appears, could be relieved of the harshest conditionality measures, provided they were prepared to impose the pain themselves.

**The Revenge of the Technocrats: Conditionality and the ECB**

The ECB also exercised conditionality. Such tools had generally not been part of the ECB’s standard practices. Since its foundation in 1998, the ECB had seldom been in a position to ask individual states to change their policy. With the Eurocrisis, this changed (Henning, 2017, 66-69) as financial distress gave the ECB leverage to insist on specific policy measures in return for financial assistance. This began in 2010 as Eurozone members began to face liquidity problems, and initial interventions from the central bank were aimed at averting the very public and visible bailouts that ultimately became necessary in the periphery countries.

As the sovereign debt crisis in the Eurozone took hold, the ECB demanded of certain member states specific policy responses as a precondition for enhanced liquidity (Woodruff 2014). In the first case in 2010, Trichet made liquidity provision conditional on both the Council’s adoption of a broader rescue mechanism (which became the European Fiscal Stability Fund) but also on specific austerity pledges by Greece, Portugal, and Ireland. In Greece and Portugal, funding was also made conditional on pledges by opposition parties to respect the arrangements should they come to power (2014: 100). The debt crisis therefore provided the ECB with a new “hard” instrument to determine member state fiscal policy, a central concern of monetary union that had eluded the easily disregarded requirements of the Stability and Growth Pact (Wyplosz 2013).

 However this opportunity was exploited by ECB governor Trichet to go well beyond fiscal and monetary matters and developed implied conditionality in other areas, notably the labour market, and in countries not subject to economic adjustment programmes. Trichet sent detailed letters to the governments of Italy and Spain in late summer 2011 calling for “intensified austerity, labor market reforms and a liberalized reorganization of collective bargaining” (Woodruff 2014, 100). Like in the formal bailouts, the letters included very specific recommendations. In the Italian letter, the government was exhorted to freeze public sector salaries in order to hit its deficit target, but also privatize local utilities, change labour market regulations and practices, and even abolish the provincial tier of the administration, none of which could reasonably be considered to be within the ECB’s remit (Corriere della sera 2011). While the letters did not mention enhanced liquidity conditions then being considered by the ECB, press reports indicate that most observers understood the reforms to be a quid pro quo for ECB bond purchases, and both governments made the suggested changes, including in the Italian case the deposing of Silvio Berlusconi as Prime Minister and his replacement by the former European Commissioner Monti (Klein 2017).

 Under Trichet’s successor Mario Draghi, ECB involvement was extended further, albeit less crudely. Under Draghi the ECB promoted the idea of a new “Fiscal Compact” that would effectively constitutionalize the recent German-Swiss innovation of a federal “debt brake.” Pushing the Fiscal Compact was one of the first moves of new ECB-President Mario Draghi in late fall 2011, and access to the ESM was made conditional on ratification of the Fiscal Compact (European Parliament 2014, 102). As a result, some member states (including Greece, Spain, Italy, and Portugal) were required to amend their constitutions to incorporate commitments to balanced budgets (European Parliament 2014).

The crisis was finally brought under control when the ECB acted in a future-oriented way to embed conditionality into a provisional program, that of Outright Monetary Transactions. Under Draghi’s leadership, the ECB embedded conditionality into any future use of OMT, which allowed the ECB to engage in unlimited intervention in bond markets. In other words, monetary policy responses were conditional on fiscal policy changes or on labor market or other structural reforms.

**From Lever to Club, and Back Again?**

These new Commission and ECB roles in exercising conditionality in core state functions help shed light on otherwise puzzling developments elsewhere in the literature.[[12]](#footnote-12) For example, new research on the European Council (Puetter 2014) explicitly denies any prominent role for “hierarchy” in the “new” domains of economic governance and monetary policy (Puetter 2014). According to this view, as member states have grown wary of the Community Method, they have developed important new instruments in economic policy, but these have relied on an intergovernmental process marked by substantial and sustained “deliberation.”[[13]](#footnote-13) This has entailed a major shift by the Council away from its prior focus on legislative work and towards inter-state coordination in various fora. Integration thus increases but without legal delegation but instead by cooperation from which defection remains an open possibility.

Applying this broad argument to the case of economic policy, Puetter finds that the member states have sought to limit the Commission’s role in these new areas and have also prevented ECJ oversight by placing them in new treaties (e.g. ESM) or intergovernmental agreements (e.g., Fiscal Compact). Puetter is convincing in showing that the instruments of control at the Council level are not legally binding, and we can accept the idea that states can break these commitments. The evidence for this is substantial (Hallerberg and Baerg 2016). Where we break from Puetter is our insistence that quite a lot of conditionality and “hierarchy” is being used (see also Börzel 2016). Thus, we insist on the crucial point that—whatever deliberation is going on at the Council level—other agents, such as the ECB and the Commission, are both willing and able to flank and try to enforce the agreed policies.

A related case is that of Macroeconomic Conditionality, which was introduced into the structural funds programming for the 2014-2020 budget period (Jouen 2015). The core idea of this legislation introduced is that a member state’s structural fund access would depend on the state’s compliance with broader requirements of economic governance (van Hecke, Bursens, and Beyers 2016). A group of states known as the “Friends of Better Spending” and consisting of Austria, Denmark, Germany, the Netherlands, Sweden, and the UK supported this proposal, which won the backing of the Council. The core idea is that if a member state fails to comply with steps listed under macroeconomic coordination and subsequently fall into a too-large budget deficit, its access to structural funds would be suspended. Indeed, this proposal was opposed by the associations of regional governments on the grounds that regional governments could lose access to funding as a result of (national) spending patterns they cannot control (van Hecke, Bursens, and Beyers 2016). The final legislation foresees that structural fund projects can be “suspended” by the Commission if a state is in excessive deficit and also “cancelled” if such deficits persist (Jouen 2015, 5).

The application of these arrangements has evolved recently as the most acute phase of the Eurozone crisis has been overcome, particularly since the beginning of quantitative easing substantially diminished member state financing pressures (European Central Bank 2015). The need to avert a run on sovereign debt and national banking systems has been superseded to some extent by concerns over the legitimacy of supranational micromanaging and the rise of populist forces demanding a restoration of national sovereignty, most notably in Greece, Spain and Italy (Hopkin 2015). The failure of some of the more optimistic forecasts for economic recovery have undermined the credibility of arguments for strict budgetary policy: even the alleged success stories such as Spain and Ireland still carry eye-watering levels of debt and have seen living standards struggle to recover, whilst Greece remains trapped in a form of permanent external surveillance and financial dependence. This shift has brought a softening of the European institutions’ stance on conditionality and a less ambitious approach to structural reforms and debt reduction in the troubled member states.

**Conclusions**

This paper has analyzed how the EU came to develop conditional instruments during the enlargement process of the 2000s and then began to develop similar logics again after the onset of the global financial crisis in 2008. Our central worry is that the contemporary EU’s overextension of its conditionality tools may result in a kind of simplistic and “truncated” developmentalism. In some cases, this set of tools seems highly inappropriate in some of the contexts they are being used.

This paper shows that the recent Southern European experience suggests conditionality has significant limitations in achieving the goal of structural reform, and works differently in cases where countries are already inside the EU and the eurozone. One obvious difference is that, in the absence of a specific reward to be dangled before national level policymakers, elected politicians have less incentive and fewer resources to mobilize political support for reforms. The experience of the same countries’ accession to the single currency in the 1990s is instructive—policymakers were able to win support for unpopular measures by evoking the sunny uplands of a more prosperous future within the euro area. Romano Prodi’s “Eurotax” is a good example of this. More short-term negotiations on the release of bailout funds or the provision of central bank financing lack these characteristics, in particular because national policymakers are aware that the bailouts are of mutual advantage to creditors and debtors, but also because the nature of the political path to the reward precludes political mobilization around it.

The other obvious difference is that the policies upon which financial aid is made conditional are unable to achieve the broad goal of structural reform that implicitly or explicitly informs them. Specific fiscal requirements aimed at reducing deficits do not preclude that inefficient, corrupt or clientelistic patterns of public spending and regulation can continue. Exhortations to reform economic institutions, such as labour market regulations, can fall on both the legislative process, as measures are watered down (such as for instance labour reform in Italy), or in implementation, as judicial institutions reverse or nullify the intended effects of reform. The essential weakness remains that conditionality sits uneasily with member state-level democratic institutions. If what the Troika or the Commission want is unacceptable to democratically elected representatives, or even to those involving in implementing policy, then it is likely to fail. In this sense there is a principal-agent dynamic, with the member state governments acting as agents with far greater knowledge and control of national institutions than any external monitors can muster.

We can conclude that this new conditionality has proved maximalist and aggressive, to some degree by design; and it was unlikely to bear the fruit the Council and Commission desired, given the flawed nature of the theories underpinning the policy programme deployed and the predictable political backlash to the bullying nature of some of the adjustment programmes imposed as conditions of financial rescues. In sum, up to now conditionality in the eurozone context seems to be working much as the experience of structural adjustment programmes in other parts of the world would predict. As Greer (2014) explains, “The null hypotheses from the large literature on structural adjustment policies suggest that the (they) will: be badly implemented; be neutral or bad for growth; be bad for equity and the poor; have unpredictable policy consequences; and will allow incumbent elites to preserve their positions.” Preliminary evidence from Southern Europe confirms that the same problems are arising. One caveat to this, however, is that established partisan and governing elites in Southern Europe are under severe pressure, with electoral breakthroughs by populist alternatives in Greece, Italy and Spain threatening an outright rejection of the policy prescriptions imposed from outside.

This is in contrast to the more benign role conditionality appeared to play in the enlargement process. By comparing the cases we can see that conditionality has been more likely to succeed when used as a “lever” to facilitate reforms by supportive national elites, particularly when relating to the politically less controversial non-core state functions involved in the membership perspective, and where the European institutions have the ability to control the rewards for compliance. In the Eurozone debt crisis, these conditions have been lacking. National elites were often less than supportive, particularly since the measures imposed were politically highly sensitive, and extremely painful for national populations in the short-term, with uncertain benefits in the long term. Although the ability to provide financial assistance was an important reward available for compliance, it preceded the actual implementation of the conditional measures, whereas the long-term reward, a return to economic growth, was not in the gift of European decision-makers.

Not only has this latest episode of conditionality had decidedly mixed results in policy evaluation terms, it has ruthlessly exposed to European decision-makers and voters the trade-offs involved in participation in the European project, and in particular its monetary aspect. European Union membership can mean non-elected technocrats arriving on missions to open up member state governments’ books and demand the implementation of deeply unpopular policy measures, with little pretence that there is much scope for negotiation. Predictably, this has placed pro-European political elites in debtor countries under political pressure, creating opportunities for nationalistic appeals to make electoral hay. Even when the populist threat can be held off, as in Spain and Italy, member state governments can appeal to European decision-makers for a softer touch, for fear of something worse. The limits of conditionality are ultimately to be found in the electoral nexus at the member state level.

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1. We do not, however, pursue here a causal argument that each stage of conditionality determined the subsequent one. Demonstrating this connection would require additional interviews in all major EU institutions. [↑](#footnote-ref-1)
2. Lütz and Kranke stress the more orthodox position of the EU Commission relative to the more lenient IMF (2014), while Woodruff stresses the extreme orthodoxy of the ECB (2014). Of course, both the Commission and even the “independent” ECB are subject to strong pressures by powerful member states, many of whom have pushed hard for conditionality to be imposed on debtors. [↑](#footnote-ref-2)
3. To be sure, the EU’s Copenhagen criteria, which included democratic rule and a functional market economy, clearly did involve core state functions. We treat these as a pre-requirement for opening negotiations and would not deny that the EU thus had some influence over core state functions. Our point is that the EU generally did not use its formal conditionality instruments for core state functions. For a list of the 35 screening chapters, see https://ec.europa.eu/neighbourhood-enlargement/policy/conditions-membership/chapters-of-the-acquis\_en. [↑](#footnote-ref-3)
4. Hungary and Romania are not EMU members, and Latvia was not at the time of the IMF program. [↑](#footnote-ref-4)
5. Official pre-accession assistance for the relevant 2000-2006 budgetary period amounted to 22 billion euro, which includes, Phare, ISPA, and SAPARD. See http://ec.europa.eu/enlargement/archives/questions\_and\_answers/11-22\_en.htm#costs [↑](#footnote-ref-5)
6. Add data on the deterioration of debt/GDP levels in some Southern economies during the period of austerity. [↑](#footnote-ref-6)
7. Woodruff (2014) links conditional policies also to ordoliberal ideological impulses emanating mostly from Germany. Thus, we do not insist that CEE experiences were the only route through which ideas about conditionality entered the EU institutions. [↑](#footnote-ref-7)
8. The World bank also added a small amount ($1.3 billion). [↑](#footnote-ref-8)
9. The ECB had little involvement in these programs because these CEE states were not Eurozone members, though Latvia later joined the EMU. See Aslund 2010. [↑](#footnote-ref-9)
10. Romania’s exit from its IMF program took longer. For details, see Ban (2017). [↑](#footnote-ref-10)
11. “Eurozone approves massive Greece bail-out” , *BBC News*, 2 May 2010 http://news.bbc.co.uk/1/hi/business/8656649.stm [↑](#footnote-ref-11)
12. The ECB also used conditionality on the question of exactly how the Irish retired bond debt. [↑](#footnote-ref-12)
13. Puetter (2014) extends this argument to foreign policy and employment policy as other examples of new domains of Council/European Council activity. [↑](#footnote-ref-13)