Kevin Featherstone
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Conditionality, Democracy and Institutional Weakness: the Euro-crisis Trilemma

Kevin Featherstone
European Institute
London School of Economics and Political Science
Houghton Street
London WC2A 2AE
k.featherstone@lse.ac.uk
**Conditionality, Democracy and Institutional Weakness: the Euro-crisis Trilemma**

KEVIN FEATHERSTONE

London School of Economics and Political Science

**Introduction**

The sovereign debt crises of the eurozone have raised a set of systemic challenges for the European Union (EU) that questions the credibility and legitimacy of its governance across two levels, European and domestic. The challenges are both instrumental and normative. The critical case in these respects is Greece: in 2015, it needed a third bail-out, but it also launched a political confrontation with the EU following the election of a leftist-led government. The political drama made the enduring challenges even more acute. Firstly, there were (and are) questions of leadership. How could the eurozone provide leadership and lever domestic reform to keep Greece inside the euro? Was there the political will to do so, at either the European or national levels? Further, there was the institutional challenge that stems from the juxtaposition of complex and disparate leadership at the EU level with low-quality institutions for policy delivery domestically. Beyond the structural conditions, there are normative questions of the terms of the rescue, but also issues of the accountability and legitimacy of the decision-making process. What can elections decide in a state under an adjustment programme? Together, these challenges pose a conundrum that is existential in nature for the EU: a trilemma in which the external leadership of reforms via conditionality confronts national democratic choice and the operational deficiencies of weak domestic institutions.

This contribution considers the three themes of the conundrum as evident in the continuing Greek debt crisis of 2015 and the implications for eurozone governance. Section 1 considers the literatures covering IMF rescues and EU conditionality to illustrate key aspects that have made the Greek ‘rescue’ problematic. Section 2 examines the particularly intense negotiations Greece had with its eurozone partners over the course of 2015 to highlight the conflicting political interests and bargaining dynamics. Section 3 links these to the normative challenges of choice and legitimacy for the EU stemming from the Greek crisis. Section 4 discusses the problems of institutional capacity at both the EU and the domestic levels as a structural constraint on performance. The conclusion draws these strands – the strategic, the institutional and the ideational - together and considers what lessons are apparent from this case for the understanding of the euro system. The eurozone’s design and operation faced its biggest systemic shock in 2015. Evidently, Member State expulsion was now possible. In the face of a deepening debt problem, the eurozone embedded itself even more deeply into ordo-liberal austerity, the EU Commission was forced to draw serious lessons about its engagement with national government administrations and the eurozone’s response to popular protest was to face it down. This leaves the single currency regime skewed and vulnerable.

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1 I am grateful for the assistance of Michalis Cottakis and for the comments of George Kyris and the editors of the *JCMS Annual Review*. Any errors remain mine alone.
I. Conditionality is barely working

With the first Greek bailout of May 2010, the EU embarked on an unprecedented programme of loan conditionality with a eurozone Member State. Given that two further bailouts have been deemed necessary, the question arises as to why the conditionality strategy has seemingly proved ineffective for Greece. By contrast, it appeared to have met with more success in Ireland, Portugal and Cyprus.

The wider literature on the performance of IMF rescues internationally suggests a number of structural factors that are relevant to explaining the difficulties of the Greek case. More particularly, support for reforms amongst key stakeholders has long been recognised as a prerequisite for success (Rodrik, 1996). In a large comparative study, Ivanova et al (2003) found that political systems with strong vested interests and high political polarisation were less likely to deliver on externally-mandated reform programmes. The Greek system has traditionally displayed pronounced levels of political conflict within the party system and a ‘disjointed corporatism’ amongst government, business and unions, greatly reducing the scope for reform by consensus (Featherstone, 2005; Lavdas, 1997; Lijphart, 2012). The impact of the crisis was to intensify political conflict. While it is true that Greece since 2011 has experienced unprecedented (post-war) periods of coalition government, Ivanova et al (2003) also identified multi-party governments as less likely to succeed with reforms, providing more opportunities for conflict. Pop-Eleches (2009) argued that conditionality was unlikely to work if both the government and the opposition had divergent ideological preferences from the IMF, a matter also related to the intensity and nature of the rescue task. In 2010, the reform content of Greece’s rescue flatly contradicted the reflationary aspirations of the PASOK (socialist) government of George Papandreou and the stance of the main opposition, the centre-right New Democracy party, was to oppose the bailout of that year on the grounds that it was too draconian, though it was also seen as being opportunistic.

In the literature on IMF conditionality\(^2\), the effectiveness of reform is seen as being dependent on the number and extent of the specified reforms: the greater the conditionality, the less space there is to build reform coalitions and encourage ‘ownership’ by the government (Beazer and Woo, 2015; Bird and Willett, 2004). Certainly, the conditions set for Greece across its successive bailouts have grown in scope and number.\(^3\) In parallel, though, the space for dialogue, domestic prioritisation and choice, and building consensus has been very limited. This, in itself, has undermined the basis for ‘ownership’ of the reform programme as it weakens the standing and legitimacy of the domestic leaders of reform. Moreover, the IMF experience suggests that right-wing governments will find it more difficult to implement reforms if the conditions are extensive, as this will create scope for left parties to oppose each new condition while restricting the scope for the government to compromise and compensate the losers from the reforms (Beazer and Woo, 2015). Extensive conditionality ties the hands of governments that need the most flexibility to see reforms through (Beazer and Woo, 2015). As the acceptance of the Troika reform programme by Greek governments in the 2010-14

\(^2\) I am grateful to Antonio Barroso for assistance with this literature.

\(^3\) The Second Economic Adjustment Programme was substantially longer than the first (as were the associated review documents) and, though the third was shorter, the range of policy areas covered has continuously expanded across all three.
period was sufficient for them to be seen as ‘right-wing’, the opposition in the form of the SYRIZA party was provided with much opportunity to attack the extensive conditions in the programme. In parallel, the legitimacy of centre-left and centre-right leaders plummeted.

Seen in the context of the literature on IMF conditionality, the Greek case has thus displayed exceptional characteristics and this helps to explain its problematic performance. Further evidence of its exceptionalism may be gained from a more agency-centred approach that highlights the contradictory rational interests of domestic actors. With respect to EU enlargement, Schimmelfenning and Sedelmeier (2004, p. 663) developed a now classic ‘external incentives model of governance’ in which the domestic actors involved are assumed to be strategic utility-maximizers interested in the maximization of their own power and welfare. As such, it follows a standard ‘logic of consequences’ (March and Olsen, 1989) in which the EU maintains a strategy of reinforcement by reward and the hypothesis is:

that a state adopts EU rules if the benefits of EU rewards exceed the domestic adoption costs. In turn, this cost–benefit balance depends on (i) the determinacy of conditions, (ii) the size and speed of rewards, (iii) the credibility of threats and promises, and (iv) the size of adoption costs (Schimmelfennig and Sedelmeier, 2004, p. 664).

In the Greek case, the depth of the recession has created an intensity not matched in the other eurozone states involved in rescue conditionality and the stakes have been much higher.

The Schimmelfennig and Sedelmeier model was developed for a different type of case: that of states wishing to join the EU ‘club’, rather than the setting of conditions to remain with the eurozone. Yet, the differences are illuminating for why conditionality in the Greek case has faltered so much. For Greece, the size of the adoption costs has been frequently seen as high and impacting in the short- and medium-term. With unemployment reaching 27 per cent (and almost two-thirds of those aged 24 or younger), salary cuts of up to 32 per cent for workers aged below 25 years (ELSTAT, 2015), pension reductions of between 40-50 per cent for public sector workers (European Parliament, 2015) and bankruptcies at record levels, the socio-economic environment for major structural reforms has been very difficult. Moreover, with strong political conflict over the bailouts, ministers charged with reform have incentives to protect their own positions by thwarting the implementation of reforms (Zahariades, 2013), a process partly facilitated by the ‘siló’-like fragmentation of central government and the weaknesses of the prime minister’s position (Featherstone and Papadimitriou, 2015). Since 2010, governing parties have faced major challenges in maintaining party unity: PASOK has almost disappeared as an electoral force and SYRIZA endured splits in mid-2015.

At the same time, the size and speed of the rewards for compliance have been questionable. Beyond the important immediate domestic sphere, the long-term projections for public debt have offered little incentive for short-term sacrifice: with each successive bailout, the time when Greece will return to the pre-crisis debt levels – themselves exceptionally high – has been put back well beyond 2020. Moreover, the immediate reforms have often been horizontal in nature: cutting salaries and pensions across-the-board, creating many losers and few winners. This has undermined the scope to build a stronger pro-reform domestic coalition.

Over the successive Greek bailouts, it has been evident that the creditors have felt obliged to be more precise in the determinacy of the conditions set. While, in principle, this can be regarded as
conducive to conditionality compliance, the cost can be to exacerbate the sense of external imposition and the squeezing-out of a dialogue on reform with domestic allies (Featherstone, 2015). Greek public debate has, indeed, focussed on the immediate imposition and pain, to the neglect of a domestically-driven consideration of alternative models and objectives. A notable example of the over-determinacy of loan conditions for Greece came with the first Greek loan Memorandum setting a target of Greece shedding 150,000 public servant posts between 2011-15. This was not a figure developed on the basis of an assessment of staffing or skills needed; it was purely a calculation derived from the budget savings required of Greece. In a highly sensitive sector, the target became almost impossible to be defended by domestic reformers. It contributed to destroying political careers and undermining support for reform agendas (Featherstone, 2015).

Having endured considerable hardship, opponents of the bailouts came to question the credibility of the threats behind non-compliance with the conditions imposed on Greece. Public opinion has overwhelmingly wished to remain inside the ‘euro’, but the opposition became increasingly successful in arguing that Greece’s creditors would not risk ‘GREXIT’. This was seen as going ‘nuclear’, involving mutually-assured losses, and the call was for Greek leaders to stand-up and call the bluff of Germany and the others. The path set by the eurozone was criticised as being against the interests of all, a theme endorsed by some leading international economists like Paul Krugman (2015) and Joseph Stiglitz (2015), and a Greek challenge could open-up a new European-wide political struggle. No Greek politician was more successful in these arguments than Yanis Varoufakis, an academic economist come-TV star and briefly a SYRIZA frontman. He had written many years previously of actor strategies in the context of ignoring incredible threats and being prepared to gamble (e.g. Hargreaves-Heap and Varoufakis, 1995). At the start of 2015, Varoufakis became Greek Finance Minister, following SYRIZA’s election victory. He was to serve less than six months in office, but in this time he stunned the world by his audacity and his celebrity manner, a style that was a gift to the media. Afterwards, he was left to write his personal account of his experience (Varoufakis, 2016).

In reality, of course, the seduction was shared by a party and an electorate strongly opposed to the austerity of Greece’s bailout terms. SYRIZA’s election campaign (with its slogan ‘Hope is coming; Greece goes forward; Europe is Changing) offered the promise of ending austerity while still staying in the euro. To television interviewers querying whether the party had a fall-back position, SYRIZA leaders emphasised that Greece’s eurozone partners would back down.4 The electorate seemed persuaded. In the last week before the election, a GAP opinion poll found 56 per cent of Greeks believing that, if it came to a confrontation between Angela Merkel and Alexis Tspiras, the former would concede. After his election victory on 25 January, Alexis Tspiras as the new prime minister, declared an ‘end to the vicious cycle of austerity’5.

By 2015, the loan conditionality had seemingly come unstuck in Greece. The lenses of IMF and of EU enlargement conditionality highlight the key differences of the intervention in Greece: the uncertainty of reward and threat; the intense political conflict and a lack of ownership; the use of

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4 Star Channel, 13 January 2015
5 Kathimerini, 26 January 2015.
rather crass targets; and, the severity of the recession. That said, the bailout was not without some achievement: the Greek economy finished 2014 out of recession, albeit with a fragile growth path.6

II. Varoufakis’ game of ‘chicken’ with Europe

The ‘game of chicken’ that Varoufakis initiated with Greece’s euro partners in 2015 was without parallel in EU politics, with the stakes high for both sides.7 Moreover, collectively the players in Greece had almost no experience of public office; their ambition, however, was grand-scale. In elaborating how the game played out, a number of important characteristics become evident: the importance of the time constraint; the predictability of the eurozone’s response; the precariousness of Greece’s finances and the government’s attempts to find cash; the isolation of the Greek government at the EU level; the lack of trust underlying the bargaining; the real threat of expulsion; and a clear defeat for Athens.

The first factor was time. The previous New Democracy-led government of Prime Minister Antonis Samaras had left matters unresolved until after an election it feared it might lose. It had not satisfied the conditions for the last tranche of loan funding (totalling €7.2 billion) under the second bailout and the agreement was due to expire by the end of February 2016. The new government had to face the tough reality. One week before this deadline, the Euro Group agreed to extend financial support to Greece for a further four months to allow the earlier conditions to be met by Greece and on the basis that the country would continue to honour all its debts, continue with the previously agreed reforms and not take any unilateral measures, while the extension period could be used to negotiate a further programme of support. The agreement did foresee Greece having a lower primary budget surplus target for 2015 (than 3 per cent), which would provide some scope for fiscal easing. But, it also moved the bank recapitalisation funds for Greece to the EFSF (European financial stability fund) beyond the reach of the new Greek government. Overall, the terms of the extension were widely seen as a defeat for the SYRIZA-led coalition, as it had not secured any of its main election demands.

A few days later, the Greek government submitted its first list of reforms that it would implement in order to satisfy the completion of the second bailout. On 24 February, the Euro Group accepted these as a ‘valid starting-point’ for an agreement that would be necessary by the end of April. However, subsequent iterations of these reform proposals were repeatedly rejected by the Euro Group as insufficient. The contentious issues involved further pension cuts, increases in VAT rates, debt-restructuring, increased flexibility in the Greek labour market and the setting of a lower budget surplus for 2015.

The Greek government’s attempts to win allies within the eurozone came to nought. Its failure was fundamentally due to the wide divergence in policy stance and conflicting interests. This was already clear well before SYRIZA took power and it raised questions as to how it believed it would be able to change the terms of engagement with the eurozone. As Tsebelis (2015, p. 3) has commented, ‘[t]he Greek leadership did not understand that the negotiating deck was stacked in the EU’s favour

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6 See Benczes and Szent-Ivanyi’s contribution to this volume.
7 On developments in eurozone governance in 2015 see Hodson’s contribution to this volume; more generally, see Copsey (2015).
and wasted time learning the obvious’. Much of the eurozone’s response was path-dependent behaviour. Rather than the crisis creating a critical juncture for policy change, it invested more deeply in the original ordo-liberal paradigm, as I have argued previously (Featherstone, 2012). The orthodoxy maintained a straitjacket and credibility risked no flexibility.

Moreover, these factors were soon overlaid by unprecedented levels of mistrust of the Greek government – indeed, disdain for its stance and its behaviour - from its eurozone partners. Varoufakis’ personal relations with his German counterpart, Wolfgang Schäuble, were quickly antagonistic – with the former saying ‘We didn’t even agree to disagree’, after an early meeting in February. Even before SYRIZA took office, Schäuble (2016) had warned Tsipras he could not both remain in the eurozone and reject the agreed bailout programme. There was also the sense that Greek leaders were behaving improperly. Varoufakis upset Pier Carlo Padoan, the Italian Finance Minister, by declaring on TV in Rome that the Italian debt was also ‘unsustainable’.8 In June, Tsipras commented that the IMF had ‘criminal responsibility’ for the damage to the Greek economy.9 For her part, IMF Chief, Christine Lagarde, lamented the slow progress of the creditors’ negotiations with Greece and said there was an urgent need for dialogue ‘with adults in the room’.10 Commission President, Jean-Claude Juncker, who began with one of the more consensual approaches, effectively accused Tsipras of lying to the Greek Parliament at the end of June in his account of the negotiations. The Greek PM had presented the eurozone’s latest offer as one of ‘take it-or leave it’, but according to Juncker, Tsipras knew ‘perfectly well that was not the case’.11 The Commission President said Tsipras had to ‘observe some minimum rules’ of behaviour. Jeroen Dijsselbloem, President of the Euro Group, was repeatedly exasperated with Varoufakis’ tactics. When he left office, Varoufakis observed ‘I shall wear the creditors’ loathing with pride’. In April, Tsipras went to see Putin in a crude attempt to suggest an alternative ally for Greece, but Moscow offered little. Diplomatically, Greece had shown abject failure.

Throughout, Greece remained isolated: one against eighteen. Given its policy stance, the scope for it to build a counter-coalition to Germany was limited. Recent French governments have had a much weaker voice in the eurozone than at its Maastricht birth (Dyson and Featherstone, 1998). Michel Sapin only made muted noises in Greece’s support. Later, Varoufakis would also conclude that Greece’s success would have been the ‘greatest nightmare’ for Portugal, Spain, Italy and Ireland.12 But, it is more arguable that there was room for a less harsh deal than that eventually obtained. Clearly, Greece lacked credibility and commitment on the terms being proposed. A lack of trust probably reinforced the attractiveness of ‘GREXIT’ and undoubtedly placed the option more firmly on the table, with secret contingency plans in Berlin and elsewhere being updated.13

The slowness of the negotiations increased the eurozone’s exasperation with Athens.14 Athens rejected both an exit from the eurozone and the imposition of ‘rescue’ terms that it saw as repeating

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8 The Guardian, 2 February 2015
9 The Daily Telegraph, 16 June 2015
10 The Guardian, 18 June 2015
13 Indeed, well after the third bailout was agreed, mistrust and low credibility were a continuing problem as evident from the leaking of a private telephone conversation between IMF officials – a matter that led to angry exchanges between the IMF’s Christine Lagarde and Tsipras (Financial Times, 3 April 2016).
14 Kathimerini, 23 April 2015.
past failures. By April, the Greek government was running out of money. It compelled pension funds, state corporations, regional and local authorities, and universities to transfer cash reserves to sustain its operational needs.\(^{15}\) Adding to the pressure, the IMF refused a delay in Greece’s debt repayments – something that no developed economy had previously requested. With a poor atmosphere and a sustained impasse, Tsipras made changes to the Greek negotiating team. Varoufakis was moved aside and Euclides Tsakalotos, a deputy minister of international financial relations, was placed centre-stage as the coordinator. Tsakalotos was much closer to Tsipras and had a far more consensual manner.

Greece’s situation became increasingly precarious. At the start of May it managed to make a debt repayment of €200m to the IMF and then another later of €750m, but only with money held at the IMF itself. By the end of May, Greece was warning that it might be forced to default on €1.6bn debt repayment due in June, claiming it had to prioritise the payment of wages and pensions at home. Indeed, Athens informed the IMF that it would delay its repayments till the end of the month.

With the expiration of the bailout extension approaching at the end of the month, the rest of the eurozone offered to extend it by a further five months (though with no extra funding). This was rejected by Athens on 26 June as too draconian. Instead, Alexis Tsipras in the early hours of the morning announced a referendum on the most recent proposal made by the eurozone side. His government would advocate a ‘no’ vote in the referendum to what he described as ‘blackmail’ and ‘humiliation’. Greece’s partners viewed this as breaking-off the negotiations that were ongoing; they had expected a further counter-proposal from Athens. The creditors refused a one-week extension beyond the referendum date. Thus, the second bailout programme, and the funds earmarked from it, expired; Athens had not received any funding since the previous August. This intensified Greece’s budget predicament and it decided to default, as it had already signalled, on an IMF loan of €1.5 billion at the end of June. The ECB also froze its emergency funding of Greece’s banks, leading to Greece having to introduce capital controls to stop money leaving the banking system. Foreign transactions were severely limited and the banks were shut (for three weeks). The Athens stock market was also closed. The government took emergency steps: delaying paying its private contractors and ordering public utilities to transfer their reserves to the central bank.

The referendum was a very hurried affair taking place just a week after it had been announced. The question in the referendum was neither clear nor, perhaps, even valid, as several EU leaders, including Commission Vice-President Valdis Dombrovskis and Christine Lagarde pointed out.\(^ {16}\) Greece’s highest administrative court also queried the legitimacy of the referendum and the question’s validity.\(^ {17}\) The text of the question was long and opaque. The text it referred to was mostly not in Greek. More particularly, the proposal had already been withdrawn by Greece’s partners. But politics overrode the actual text and the government saw it as a pro-/anti- austerity issue. Crucially, it stressed that this was not an ‘in-out’ choice over the euro – though both Merkel and Hollande declared that a ‘no’ vote would, indeed, be a vote for exit. On 5 July, 61.3 per cent voted ‘no’ on a turnout of 62.5 per cent. SYRIZA trumpeted it as a popular rejection of the austerity imposed by the eurozone.

\(^{15}\) Kathimerini, 23 April 2015.


\(^{17}\) The Guardian, 3 July 2015.
Yet, a week later, the government was obliged to accept terms that, in many respects, were even more punitive than before. Indeed, the deal was worse than that which had been floated at the time of the Samaras government the previous autumn. Greece’s eurozone partners, led by the Merkel Government, were intent on reaffirming the policy frame that she must follow – ‘rules are rules’, as Schäuble had it (2016) – and to exorcise any impression that SYRIZA’s irresponsibility had produced rewards.

In the days after the Greek referendum, the onus was on the Greek government to submit fresh proposals. Two days later, Varoufakis resigned as Greece’s finance minister and Tsakalotos replaced him, seemingly easing relations with the rest of the eighteen. But, in the air of scepticism and uncertainty, Schäuble’s office the following Friday circulated an email to eurozone partners that stipulated that in the absence of an acceptable submission from Athens over the weekend then by Monday, ‘Greece should be offered swift negotiations on a time-out from the eurozone’ of some five years’ duration. Further, Greece should be obliged to transfer assets worth €50 billion, a quarter of its national wealth, into a trust fund located in Luxembourg. The assets would be sold-off gradually and the proceeds used to pay-off the Greek debt. It was modelled on the privatisation scheme for East German property after 1989. The German move was sharp and threatening. In any event, Tsipras had presented proposals to the Greek Parliament that evening that were very similar to those just rejected in the referendum and had obtained the overwhelming support of MPs for them. Though the next day both the EU Commission and the ECB declared the Greek submission as a good starting-point, they proved not enough – both the Finnish and Slovak finance ministers pressed at the start of the negotiations in the afternoon for Greece’s expulsion from the eurozone. The finance ministers’ negotiations became increasingly bitter and inconclusive. Jeroen Dijsselbloem, as Chair of the Euro Group, circulated a paper on Sunday morning that retained the option of Greece’s exit. A full European Council had been scheduled for late Sunday – again, a signal that the agenda would be how to deal with Greece’s departure - but Donald Tusk, the Council President, decided to restrict it to eurozone heads. By late Sunday, the negotiations were focussed on Tsipras, Merkel, Hollande and Tusk – who often had separate meetings, leaving the rest idly standing-by. In the early hours of Monday 13 July, Tsipras battled for his redlines: no state assets transferred to an overseas trust fund; no IMF involvement; and no rolling-back of SYRIZA’s recent reforms. Between 4am and 7am, the same ‘inner group’ reconvened to struggle over a compromise: Greek state assets would be transferred to a fund based in Greece (not Luxembourg) and €12.5 billion of the total of €50 billion would be available for ‘investment’. The compromise had been crafted by Dutch PM, Mark Rutte, and his Portuguese counterpart, Pedro Passos Coelho. Instead of the ‘Troika’, four institutions (the IMF, the EU Commission, the ECB and the European Stability Mechanism) would oversee the new bailout. Some of SYRIZA’s reforms would remain, though there would be new, tougher cutbacks. It was envisaged that the new bailout could provide up to €86 billion in loans for Greece over three years.

Formal negotiations – the “Memorandum of Understanding” – on the detail of the programme were concluded in mid-August. The first loan payment to Greece of €23 billion (including €10 billion reserved for bank recapitalisations) was made on 20 August. By the end of the year, the
recapitalisation of the Greek banks had been completed at a much lower cost than expected. However, at the same time, the creditors' representatives were again seeing the Athens government as dragging its feet on the adoption of ‘13 prior actions’. The first review of whether Greece had met the terms of the new bailout stretched well into 2016 – emulating the pattern of the Tsipras government’s predecessors – with pension reforms and budget ‘black-holes’ again the points of contestation.

Politically, Alexis Tsipras continued to out-maneuvre his domestic opponents. The snap election called for 20 September 2015 secured his position in the face of the left-wing of his party splitting away. Tsipras was re-elected and the results closely mirrored those of the previous January, with SYRIZA only slightly losing support (at just over 35 per cent) and re-forming its coalition with the Independent Greeks party. Survey evidence suggested that while two-thirds of voters rated the government’s economic performance as ‘bad’ or ‘very bad’, most accepted the party’s narrative of having tried and having stood up for Greece. During the campaign, Tsipras had told Alpha TV that, ‘I feel comfortable giving people a reason to judge me for all those things I accomplished and those I didn’t.’ He said he fought as hard as he could to defend Greece’s interests in talks with its lenders. ‘The No to a bad deal, I turned it into a Yes to a deal which has problems, but provides potential’, he said.

The Tsipras Government thus finished 2015 with a deal that had kept Greece in the eurozone for the present, but one that appeared worse than might have been available a year earlier and over which it would continue to delay and haggle. Moreover, a new debt crisis could not be ruled out.

III. The EU’s normative challenge

Jyrki Katainen, EU Commission Vice President, responded to the election of the SYRIZA government in Athens and the challenge to Greece’s bailout terms with a much-quoted remark that, ‘[w]e don’t change our policy according to elections.’ It signalled the tension between EU-level agreements signed by governments and the exercise of choice and accountability in national political systems. There are inherent difficulties in the two-level system of governance within the EU where an electoral challenge is more readily expressed within domestic institutional confines, leaving the supranational level to appear imperious and unaccountable.

During 2015, Greece voted in two parliamentary elections (25 January and 20 September) and one national referendum (5 July). Each returned decisive victories for the anti-austerity political forces. Individually and collectively, however, they produced no retreat from austerity – indeed, the impact was quite the reverse. The normative question for the EU polity provoked by Greece in 2015 was, thus, what is the purpose and legitimacy of popular ballots for a state under an externally-agreed adjustment programme? When, and under which conditions, can an electorate mandate a change of policy course?

21 Kathimerini, 2 December 2015.
22 Kathimerini, 16 October 2015.
23 EU Observer, 27 August 2015.
24 EU Observer, 29 January 2015.
For in the two-level, multi-state EU polity there are cross-cutting dimensions of accountability and legitimacy. The electorates of donor-states have equal normative rights to be heard and have impact as the voters of ‘bailed-out’ systems. Thus, the rights of voters in Munich have to be counter-balanced with those in Athens. Would a default by Greece – by definition breaking an international agreement - contravene the rights of donor electorates to have their interests (and money) safeguarded? The conflict is between two moralities: that of the duty in a Union to show solidarity and that of the moral hazard: individual states should not ‘free-ride’ and ignore their obligations.

For some in Greece in 2015, the response was to argue that their ‘human rights’ were being infringed by the EU-IMF bailouts. The colourful SYRIZA President of the Greek Parliament, Zoe Konstantopoulou, a human rights lawyer, established ‘The Truth Committee on Public Debt’ on 4 April, seemingly emulating the Truth and Reconciliation Commission of post-apartheid South Africa. Critics dismissed the venture as a political gimmick and dismissed its work. The task of the Truth Committee was to investigate ‘the creation and the increase of public debt, the way and reasons for which debt was contracted, and the impact that the conditionalities attached to the loans have had on the economy and the population’ [sic] (Truth Committee, 2015, p. 1). Lest there be any doubt about its assessment of justice, its mandate was ‘to formulate arguments and options concerning the cancellation of the debt’ (2015, p. 1)\textsuperscript{25}. No allowance was made in the Committee’s report for any of the social and economic rights to be dependent on the prevailing market conditions. Rather, Greece had a right to the unilateral repudiation of the debt due to the absence of good faith, the violation of domestic laws, the precedence of human rights over other contractual obligations, the coercion in the debt restructuring, debt suspension on grounds of state necessity, and, ultimately, the right to unilateral sovereign insolvency (2015, pp. 58-62; see also Salomon, 2015). The work of the Committee was brought to a halt by the calling of the September elections and Zoe Konstantopoulou resigning from SYRIZA and joining the new Popular Unity party, led by Panagiotis Lafazanis. Later, however, Alexis Tsipras, announced a fresh parliamentary investigation in March 2016 into the debts owed by Greek political parties in an entanglement (\textit{diaploki}) of financial links with banks and media tycoons which was seen as an attack on the previous governments of New Democracy and PASOK.

These conflicts of rights - between a nation rejecting an overpowering debt-burden and an EU system protecting collective rules – added to the conflicts over solidarity and moral hazard, responsibility and accountability in a two-level system of governance. One side or the other might be criticised for indulging in populist blameshift or opportunism, but the conundrum is systemic and was brought to the fore by SYRIZA in 2015. Certainly, Tsipras’ activation of blameshift – resonating with a cultural tradition of victimhood – created a cultural resistance to reform for the sake of the bailout.

Another normative dimension of the debt crisis has been the ‘ever closer union’ between the rules and provisions of euro-governance and the economic paradigm of ordo-liberalism and austerity. Successive reforms of eurozone governance during the crisis, culminating in the EU’s ‘Fiscal Compact’ signed in 2012, have displayed a ‘lock-in’ to the ideational frame of ‘sound money, sound

\textsuperscript{25} This author was called to appear before the Truth Committee, but the calling of fresh elections terminated its proceedings.
The original treaty had itself been given a narrow normative base that overrode the disparate policy traditions of modern Europe (Dyson and Featherstone, 1999, p. 796). It stressed the importance of monetary policy and market forces for supply-side flexibility. From a neo-Keynesian perspective, the Maastricht design had major cognitive gaps: it was liable to a politics of deflation, promoting regulation rather than facilitating (re-)distributive governance, and undermining a sense of solidarity. With the eruption of the debt crisis and its asymmetric shocks, the predisposition was to punish errant behaviour and to shift the blame to mistakes made at the domestic level. The TSCG entrenched the existing rules on deficits and debt more deeply. Art. 3(ii) committed Member States to put into their national laws or constitutions that such provisions be an obligation and that a ‘correction mechanism’ for deviations be established; Art. 4 made it a requirement that national debt be kept within 60 per cent of GDP; and, Art. 8(ii) allowed for one government to challenge the fiscal position of another before the Court and the latter could impose a lump sum payment or fine (Featherstone, 2012). This represented the near-constitutionalisation at the European level of supply-side economics and of ordo-liberalism (Bellamy and Weale, 2015). As a result, the ideational frame and images of ‘Europe’ were being defined by austerity, provoking new political cleavages and popular backlashes.

Indeed, the SYRIZA-led government in Athens fanned the protests against the economic paradigm. It expressed support for workers striking against the measures it had implemented on behalf of the ‘Troika’. More fundamentally, Tsipras declared ‘I was blackmailed, there were no good options and I chose the least bad’. Thus, ‘[t]he government does not believe in these measures (and)... We will do our best to protect people from measures we do not believe in but are forced to implement’. Varoufakis, despite voting for the bailout, said the package would ‘go down in history as the greatest disaster of macroeconomic management ever.’26 Their scepticism was shared by the IMF (and a number of international economists) which assessed Greece’s new public debt levels to be unsustainable, a crucial condition preventing the Fund’s participation in a rescue. The normative choices that underlay the third bailout for Greece placed ‘Europe’ on one side of an increasingly heated debate; indeed, to some, the measures appeared so punitive that they belied an intention to force Greece out of the eurozone.

The Greek crisis in 2015 had thus challenged the eurozone’s normative underpinnings like never before. It had posed fundamental questions of when elections matter, of the rights of voters across donor and recipient states, of the moral balance between monetary order and socio-economic rights and of the tying of ‘Europe’ to ‘rescue’ via austerity. The creation of the euro regime had neglected the wider issues of governance by endeavouring to keep it as a largely technocratic project without disturbing the norms of national systems of accountability, choice and legitimacy. The Greek crisis exposed these limitations and gave rise to contrary answers at the popular level, risking elites appearing as imperious. A further governance taboo was of the ability of the eurozone to manage policies via its current institutional structures and on the basis of low-quality domestic institutions.

IV. The two-level problem of institutional capacity: European and national governance

Studies of IMF rescues have long recognised the importance of institutional capacity: the quality of the government administration correlates positively with reform delivery (Steinwand and Stone, 2008). In the Greek case, a rapid sequence of three bailouts poses questions of how the rescue strategy – and its instruments – was structured. The EU was reluctant to enter into the first Greek bailout in 2010 as it was unprecedented and it challenged the basic ordo-liberal precepts of the Maastricht agreement. The Treaty explicitly barred a bailout of a Member State government (Art. 125). It made no provision for the expulsion of an errant state, its policy coordination and ‘excessive deficit procedure’ proved weak and it failed to provide EU institutions with sufficient investigatory powers to guard against unreliable reporting of national statistics and ‘moral hazard’ risks more generally. This was a dangerous cocktail: a number of economists had already foreseen that the disciplinary rules were ‘unenforceable’ (Buiter et al, 1993, pp. 58, 90). The provisions not only delayed the first bailout, they undoubtedly increased the costs of the rescue.

The eurozone had to invent a governance structure for the first Greek bailout. In doing so, it built on the post-2008 experience of the EU in rescuing three non-Eurozone countries (Romania, Hungary and Latvia) that had encountered major debt problems. All three had been provided with both IMF and EU aid, the latter under Article 119 (of the Treaty establishing the EC), a provision for non-EMU states. The Latvian case had produced a shift. Previously, the EU and the IMF had coordinated their respective loan programmes, but from 2009 they conducted joint review missions (Lütz and Kranke, 2010). Moreover, the difficulties of Latvia were interpreted as stemming from a failure to follow EU rules. Similarly, Rogers (2012, p. 175) argues that the involvement of the IMF in the eurozone’s rescue of Greece enabled the blame for the Greek debt crisis to be placed on Athens, rather than design faults with the euro regime itself. Some EU governments – led by Germany – insisted on the IMF’s involvement in the Greek bail-out to lend the programme credibility, not least with restless voters at home. A ‘Troika’ mechanism was created, to be headed by the IMF’s Poul Thomsen, to represent the lead institutions of the European Commission, the European Central Bank, and the IMF. This was to undertake periodic review missions to Athens to gauge the government’s progress in implementing the reforms required by the loan’s conditionality (as elaborated in the ‘Memorandum of Understanding’ between Greece and other eurozone governments). Far more than in the other cases the EU had dealt with, Thomsen became a highly controversial figure - the ‘fall-guy’ for the tough austerity measures that provoked the Greek opposition – and the Troika set-up an office in Athens and regularly inspected government ministries to probe their actions. Yet, at different stages of the Greek bailout, it was the IMF that had shown a move away from the ‘Washington consensus’-type austerity measures, to a softer stance, and the EU that ‘very actively promoted orthodox measures in return for loans’ (Lütz and Kranke, 2010, p. 2). Repeatedly, the IMF questioned whether Greece’s debt would be sustainable after the bailout and in 2013 it admitted that the Greek programmes had underestimated the multiplier effects of austerity (IMF, 13/156 2013). While the EU been more disparate in its voices, it has also been pulled along by the tougher stance of the chief paymaster, Germany, and its allies.

The successive bailouts of Greece have been consistent in their implicit blaming of past governments for running-up high levels of public debt. Thus the terms of the loans must not only be corrective of the debt, but also of the behaviour that led to it – a lesson in ordo-liberal thinking. Penalties are for (past) mistakes, to defend retrospectively against moral hazard, and to assuage donor-country voters that they were not ‘being taken for a ride’. They gave little acknowledgement to how far
Greece’s lack of adjustment to the eurozone was a result of a domestic institutional incapacity to deliver reforms (Featherstone, forthcoming; Börzel et al, 2010).

The bailouts required Greece to undertake a Herculean-task. In dire circumstances, Greece implemented one of the largest fiscal consolidation programmes in history, with measures amounting to over 30 per cent of GDP (Tsakloglou, 2014). According to the OECD’s indicator of ‘reform responsiveness’ to its own three priority areas (labour market productivity, product markets and growth-friendly tax reforms) across the 2011-14 period Greece scored higher (0.81) than any of the other bailout states and the eurozone average (0.47) (OECD, 2014). Similarly, the ‘Adjustment Progress Indicator’ commissioned by Berenberg Bank and the Lisbon Council also scored Greece consistently the eurozone’s highest performer for the same five-year period for external adjustment, fiscal adjustment and the change in real unit labour costs (EuroPlus Monitor, 2014).

But the state institutions themselves remain very problematic agents of policy reform and implementation. The Bertelsmann Stiftung ‘Sustainable Governance Index’, measuring institutional quality, has repeatedly placed Greece the lowest of all OECD countries (Bertelsmann Stiftung, 2015). Indeed, the problems of public administration in Greece are well-established. It has a deeply-embedded administrative tradition displaying the influence of the Napoleonic model (hierarchical, centralist) with a stress on procedural regulation rather than innovation (Spanou, 2008) and has suffered from being low-skilled and low-tech. The institutional weaknesses affecting reform are linked to wider socio-cultural conditions. State institutions have grown amidst a politics of clientelism and corruption. Low levels of trust create a classic collective action problem inhibiting reform and sustaining something of a ‘social trap’ (Rothstein, 2005). With the Troika finding ‘a state machine deficient in its ability to deliver targeted measures on a set of priorities and according to an agreed schedule, solutions were found in horizontal cuts in public expenditure (salaries, pensions, jobs, etc.) that further recalibrated the pay-offs for political actors (Featherstone, 2015, p. 15). There were deeper ideational and cultural clashes with the Troika agenda: ‘This is an administrative setting that struggles to self-reflect, that has not prioritized norms of service delivery and of evaluation’ (Featherstone, 2015, p. 15).

The EU has struggled with an agenda of enhancing administrative capacity at the domestic level. In 2011, it established the EU Taskforce for Greece to help improve its operation and its processing of EU funding. This taskforce was to be replicated in the case of the bailout of Cyprus. In parallel, bilateral technical assistance was provided to Greece by France, Germany, the Netherlands, and other EU states, alongside the OECD. The Taskforce was disbanded in June 2015. In its place, the Commission created a new Structural Reform Service within the Secretariat-General (under Valdis Dombrovskis) to assist Member States in implementing administrative and structural reforms. The current Europe 2020 programme refers to cooperation in improving national public administrations and this agenda is included in the EU’s half-yearly reviews of economic performance for each eurozone Member State, but the process is of ‘soft coordination’. This is clearly an area of much political sensitivity across national governments as it impinges on matters of sovereignty and admissions of failure.

In the context of the instrumentation to lever domestic reform, Greece has been the critical case – an unprecedented challenge for the EU, posing a number of important strategic and operational questions. In February 2014, the European Parliament’s Committee on Economic and Monetary
Affairs (2014, p. 17) released a lengthy report on the ‘Role and Operations of the Troika with Regard to the Euro Area Programme Countries’ (Greece, Ireland, Portugal, and Cyprus). It criticised the potential for a conflict of interest on the part of the EU Commission between its traditional obligations and its role within the Troika. Similarly, it was concerned ‘that the Troika is made up of three independent institutions with an uneven distribution of responsibility between them, coupled with differing mandates, as well as negotiation and decision-making structures with different levels of accountability, [that] has resulted in a lack of appropriate scrutiny and democratic accountability of the Troika as a whole’ (2014, pp. 17-18). The transition to four institutions (the Troika plus representatives of the European Stability Mechanism) in the 2015 bailout has not erased such concerns.

An assessment of the Commission’s Taskforce for Greece by the European Court of Auditors in 2015 similarly highlighted the shortcomings of the initiative (ECA, 2015). It had been set up very rapidly, without a full analysis of other options and without a dedicated budget. It had no single comprehensive strategic document for the delivery of TA [technical assistance] or for deciding between competing priorities, despite the TFGR’s mandate to identify and coordinate the TA. In the absence of such a document, the TFGR worked with the Greek authorities ‘on demand’ and based on the programme’s conditionality (2015, p. 7). Moreover, ‘it did not systematically monitor either the way the Greek authorities followed up recommendations or the broader impacts of TA, although it would be useful for TA planning’ (2015, p. 8). In addition, there was a process problem: the Taskforce expended a lot of its time on coordination with a large number of Member States, international organisations and EU bodies.

There was much for the Commission to learn from the experience of both the Troika and the Taskforce. Strategically, its multiple roles became confused and its performance (‘output legitimacy’) appeared tied to debates over the severity of the austerity measures, with periodic controversies over whether reforms had met their targets or not. Operationally, the Commission’s intervention highlighted the fundamental problem of how to lever reform in a domestic setting of low quality public administration and high political conflict. As the EU’s chief operational agent, its effectiveness was undermined by concerns as to its lack of preparedness and planning, as well as its difficulties of coordination and feedback monitoring. Its task was daunting: to fill a vacuum at the EU level and to overcome the barriers to entry in Athens. Across the EU’s two levels of governance, there were systemic issues of institutional capability and legitimacy – paralleling those found in central Europe (Haughton, 2011).

**Conclusion**

The Greek political drama of 2015 confronted fundamental precepts of eurozone governance, highlighting issues of the effectiveness of external leverage over reform, the normative content to European obligations, the implications for democracy and accountability and institutional vulnerabilities in policy delivery. Together, these constituted a systemic shock and confronted established norms and assumptions. At one level, by the end of the year, a normality had been restored. Greece had been forced to accept a more stringent rescue and the eurozone remained largely as it was the previous January. ‘Bamboo’-like, the euro-system had been stretched but not broken.
Yet, 2015 prompted a reflection and a need for lesson-drawing. The immediate reviews concerned the institutional mechanics of the Troika and Taskforce deployment. More generally, these linked to the tentative EU agenda on building-up administrative capacity across Member States and the role that the Commission and EU aid might play. This is surely an agenda that will need to progress in the future, as the Commission’s own consultations suggest.

Strategically, Varoufakis’ game of chicken showed both the resolve of the eurozone to stick with the existing policy paradigm on rescue via austerity and the conditions under which it would countenance a Member State exit. Despite SYRIZA’s expectations to the contrary, the eurozone responded in a fundamentally path-dependent fashion. Germany’s imprint on policy was barely less at the end than at the start of the year. This indicated the continuing weakness of an alternative policy coalition, reflected in Athens uniting the rest against itself. Also, the threat of expulsion became real, even if the reward for compliance looked ever more questionable.

In parallel, however, the normative base of the eurozone looked rather more exclusive. Ideationally, Europe was hitched to ordo-liberal regulation. Two elections and a referendum in Greece had confirmed Jyrki Katainen’s comment, cited above: policy did not change as a result of any of the three voting rounds. Indeed, Greece suffered worse than before, in many respects. At the same time, the rights of voters in donor states made the normative position contested.

The implications of this case for eurozone governance are clear. It struggles with a conundrum, only more so: how to combine choice (democracy), compliance (conditionality), and capability (institutional quality) in an economy that is in crisis? As such, the eurozone faces unresolved systemic questions that make it skewed and vulnerable. How far can it allow a diversity of national economic policies, responsive to differing domestic preferences and needs? Is its insistence on an ‘ordo-liberal’-inspired conditionality commensurate with an heterogeneous Europe? How can it best intervene to overcome domestic institutional capacities to facilitate policy delivery? These questions arise from the existing diversity of the eurozone: they are not uniquely relevant to Greece, but in 2015 Athens exposed them like no other state had done before. The (non-)resolution of these questions will determine the future unity, credibility and legitimacy of the eurozone.

References


*Treaty of the European Union* (TEU), Article 125.


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