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greece in the euro

economic delinquency or system failure?

Eleni Panagiotarea

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Eleni Panagiotarea
Athens, August 2013

For Sotiris, Anna, Achilleas, and Angelos

chapter one | introduction

Banking on EMU

In April 2010, the Greek government stood on the brink of insolvency. Confronted with an inability to fund its debt, it called upon help from the European Union and the International Monetary Fund, and sought to implement unprecedented public expenditure cuts and structural reforms that would render its economy competitive within a unified currency zone containing some the world's strongest economies. Strikes, riots on the streets and disruption of public services followed, week after week, month after month.

This was supposed to be a different kind of story. Greece had banked on EMU. Entry to the Eurozone, back in 2001, was its ticket to macroeconomic stability and economic modernisation and its gateway to global markets. With the Eurozone enjoying stable growth and low inflation for most of the decade, this small country on the periphery hardly called for special mention or attention. After all, the Greek economy was also reaping benefits, as real GDP growth averaged, between 2000 and 2008, close to 4 per cent per year – against 2 per cent in the euro area.[1] If the Greek sovereign-debt crisis was a disaster waiting to happen, no one could have suspected it because, quite simply, no one was paying sufficient attention. The financial markets regularly refinanced Greek debt, while the country's Eurozone partners turned a blind eye to its budgetary problems and bad statistics.

When the markets became 'vigilant' again, after an almost decade-long intermezzo, they placed Greece, from September 2009 onwards, in a sovereign risk class of its own: the widening of its spreads in both the Credit Default Swaps (CDS) and the government bond markets constituted sufficient proof. Eurozone authorities failed to grasp both the threat of contagion and the logic of escalation, which might follow a market backlash in a setting of multiple equilibria and self-fulfilling sentiments. In the absence of a crisis-resolution framework, the increasingly frantic effort to restore fiscal sustainability led EMU leaders into a quagmire, exposing governance weaknesses that had long lurked underneath the surface.

The Greek case, special though not unique – if Ireland, Portugal, Spain and Cyprus are anything to go by – shows that EMU was always going to be about owning and sharing responsibility in a less-than-optimal monetary union in a more-than-troubled world. The derailment of Greece's IMF/EU economic adjustment programme of May 2010, the non-implementation of the second adjustment

1. European Commission, 'The Economic Adjustment Programme for Greece', *Occasional Papers 61*, May 2010, p. 3.

programme of March 2012, the renewed efforts 'to bring the programme back on track'[2] through a substantial set of reforms as well as a convincing budget for 2013, and the political agreement of 26 November 2012 to create a credible path to Greece's debt sustainability[3] – reveal how Eurozone authorities' inability to grasp the extent of system failure, combined with the delinquent behaviour of Greek policy actors, continue to haunt the political economy of the Eurozone. 'Painful' adjustment has not gone a long way and has certainly not appeased the markets: the economy is contracting for a sixth year; unemployment has soared; and fiscal and external deficits remain, in spite of 'horizontal' cuts in wages and pensions.

Great expectations turn to dust

'Too little, too late' became a standard criticism addressed to European leaders', who had been unable to fathom the risks arising from the high degree of interconnectedness of the EU financial system and unwilling to admit, at least publicly, that the EMU policy framework had failed. The rules – no default, no bail-out, no exit – proved to have been too tightly constructed, while all members had underestimated the level of interdependence among the Eurozone economies – and the fragility that came with it. Greece was not the only country in the periphery to misinterpret interest-rate convergence as an invitation to a free ride. The credit booms, the perverse effects of negative real interest rates and capital flows from northern to southern Europe[4] bred widespread content; Greece and Portugal did their best to avoid fiscal discipline altogether, while housing and asset bubbles began to float in Spain and Ireland. It was easy to point the finger to the GIIPS, regularly anagrammatised in the press and even in academic circles as PIIGS, yet less soul-searching took place in the Eurozone's core. A single monetary policy predictably failed to accommodate all, while important divergences at the national level – in wage arrangements, budgetary policies, and social regulations – eroded competitiveness, as evidenced in the mounting current account imbalances between 'north' and 'south'. Eurozone authorities were evidently misguided in their belief that national leaders who had previously delegated monetary policy-making to a new, centralised authority, would set up, whenever and wherever required, adjustment mechanisms, including wage and price flexibility, to respond

2. 'Eurogroup Statement on Greece', 12 November 2012, accessed 13 November 2012, http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/133445.pdf.

3. The agreement included an important set of measures aimed to reduce Greece's debt burden, including a debt buyback operation, return of Securities Market Programme (SMP) profits to Greece, reduction of Greek Loan Facility (GLF) interest rates, significant extension of GLF and European Financial Stability Facility (EFSF) maturities, and the deferral of EFSF interest-rate payments. See 'Eurogroup statement on Greece', 27 November 2012, accessed 9 December 2012, at http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/133857.pdf.

4. J. Pisani-Ferry, 'The euro crisis and the new impossible trinity', Bruegel Policy Contribution, 2012, no. 1, p. 2.

to macroeconomic shocks, whether asymmetric or common. Structural reforms were delayed or postponed altogether in a number of member states while wages shot up, without a corresponding hike in productivity.

How did it happen that great expectations turned to dust so quickly? As we shall see in the narrative this book relates, the roots of the Greek problem were deep and persistent, involving long-stranding rigidities and inefficiencies in an economic system in which sectional interests guarded their relative position to the detriment of the general interest and in which a political culture of patronage limited what governments could do. Moreover, the inherited institutional rigidities were complemented by failures of policy reasoning. The 'redistributive Keynesianism' of the Papandreou years of the 1980s – in which the hope was that social justice and economic efficiency could both be enhanced by positive government spending – ended in failure, just as a similar French experiment under Mitterrand was paid for by borrowing.[5] Turning to the European project seemed to offer an alternative but it resulted in a conspiracy of optimism, as both Greek negotiators over EMU and the European Union submerged hard-headed economic calculation in a wider political project that would have predictably (and predicted) uneven effects on member states when the time came for a response to asymmetric shocks.

In an ideal world, the Greeks, with an economy constituting a mere 2 per cent of Eurozone GDP, would have had to clean up their own mess. In the Eurozone world, however, a number of countries saw their government bond yields go up, forcing them, in the context of market appeasement, to contract fiscal policies sharply or, worse, adopt full-scale austerity programmes. European leaders, who had time and again, relegated the efficient management of Europe's monetary union well below political necessity, were now compelled to step in and offer, along with the International Monetary Fund, a Greek Loan Facility, worth €110 billion. The systemic character of the crisis became all too evident when questions were raised – predominantly by the markets' punitive reaction – as to whether the firewalls that had been created with International Monetary Fund aid – the European Financial Stability Facility and the European Financial Stability Mechanism – would prove a sufficient 'safety net' for Ireland, Portugal and Spain if the crisis 'spread'. Ireland negotiated its own support programme soon after and Portugal followed suit. It was then the turn of Spain to agree to a financial assistance programme for the recapitalisation of its financial institutions, while Cyprus has embarked on the euro area's fourth economic adjustment programme.

A process of institutional engineering has been unfolding though more as the result of continuous and relentless pressures from the markets than as the outcome of some grand integration design or strategic plan. The emerging rules-based system has included: a Treaty on Stability, Coordination and Governance (TSCG, popularly known as the 'fiscal compact'); the Stability and Growth Pact reinforced by the 'six-pack', a set of rules for macroeconomic and fiscal surveillance, including a new

5. P. A. Hall, *Governing the Economy: The politics of state intervention in Britain and France*, New York, Oxford University Press, 1986.

chapter four | EMU negotiations, national strategies and the external constraint

When Greek policy makers walked into the EMU negotiations that led to the Maastricht Treaty, all that they knew was that they wanted Greece 'in'. Ill-equipped and with few cards up their sleeves, they muddled through, hoping that the entry criteria would not prove too stringent. During the actual bargaining, they realised that the Treaty on European Union (TEU) and, in particular, the conditions that it set for EMU membership would constitute, if they were ever to be implemented, nothing short of a catalyst for the reform of domestic processes of planning and implementation. There arose, in their interpretation, a unique opportunity to rationalise the system of economic policy formation and endow the nominal convergence process (geared to fulfilling the convergence criteria on price stability, government budgetary position, exchange rates and long-term interest rates) with the pursuit of wide-scale reform.

This chapter traces both the negotiations that took place in the context of the EMU intergovernmental conferences and the subsequent ratification strategies used at home. The aim is to delineate the way the EMU policy framework was imported to Athens. The national interpretation and the subsequent endeavour to present EMU entry as the only available option – the economy's 'way out' from years of economic mismanagement and instability – were the central elements of the 'external constraint strategy'.[1]

In the Greek case, the government assumed a central role in negotiations, a development that was to be expected. It had to fill in the gaps in weak inter-ministerial co-ordination on the ground; it also had the resources to mould the 'national preference'. Quite predictably, policy makers who operated in two institutional orders had both the power and the opportunity to exploit 'the multiple logics' that national and supranational institutions made available to their advantage[2] and attempt to bind all the relevant non-government actors in credible commitment.[3]

1. This strategy was not unique to Greece. *See* K. Dyson, and K. Featherstone, 'Italy and EMU as *vincolo esterno*: empowering the technocrats, transforming the state', *South European Society and Politics*, 1996, vol. 1, no. 2, pp. 272–99.
2. R. Friedland and R. Alford, 'Bringing society back in: symbols, practices, and institutional contradictions', in W. Powell and P. DiMaggio (eds), *The New Institutionalism in Organisational Analysis,* Chicago, University of Chicago Press, 1991, p. 232.
3. *See* A. Moravscik, *The Choice for Europe: Social purpose and state power from Messina to Maastricht*, Ithaca/New York, Cornell University Press, pp. 3–10.

The organisational politics of EMU: setting and negotiating the Greek position

Inter-ministerial co-ordination: formal rules and informal practices

Nine months into the EEC-backed stabilisation programme, Greek policy makers had very little to show for their supposed ‘policy overhaul’. When they walked into the intergovernmental conference (IGC) on EMU, therefore, their negotiating strategy suffered from the lack of either a credible narrative or a coherent set of positions. Domestically, the prospect of participating in ‘constitution-building’ negotiations generated a debate over the role of inter-ministerial co-ordination and the respective roles that the Ministry of National Economy (MNEC) and Ministry of Foreign Affairs (MFA) would be called on to play. The Greek side had placed progress on political union (EPU) at the centre of its strategy, with its ‘Memorandum on Political Union’.[4] The MFA, therefore, expected to take precedence in inter-ministerial co-ordination, over-shadowing the MNEC. This was a change of stance; traditionally, its position on ‘Europe’ was affected by a prevalent diplomatic-service ethos that had defined European affairs as an area of ‘low politics’ and by a corresponding view that ‘working for the General Directorate of the EU, which had under its exclusive jurisdiction the management of Greece’s membership of the EU,[5] was a demotion’.[6]

The co-ordination of European policy had, in any case, formal institutional underpinnings: the enactment of Law 1104/80 had created a bi-polar system, whereby the MFA managed all the political aspects of Community membership (institutional issues, enlargement, Treaty revision, political union), the Community’s external economic relations, and European political co-operation. It was also responsible for the co-ordination and adjustment of Greek legislation, economy, and administration to the Community status quo.[7] The MNEC had control over Economic and Financial Affairs Council-related matters, structural policy, and the implementation of the internal market.[8]

The system suffered from several problems; for one, multiple hierarchies tended to exist *within* the ministries, as Prime Ministers assigned powers and responsibilities to Alternate and Deputy Ministers, often at the expense of the Minister; ‘all too often, Ministers, Alternate Ministers, and Deputy Ministers who subsequently fought for territory, pursued the same agenda in parallel ways, using

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4. *See* discussion in Chapter Two.
5. Presidential Decree No. 11, *Government Gazette*, 27 January 1992.
6. Interview 6: ‘Safeguarding the national interest in Greek-Turkish relations had historically dominated the Ministry’s policy agenda; the idea that European affairs were an area of “low politics” defined policy makers’ attitudes until the early 1990s’.
7. Art. 3, Law 1104/80 ‘Regarding the representation of Greece in the European Communities, foundation of Diplomatic and Consular Authorities and the Regulation of other relevant organizational matters’, *Government Gazette*, No. 298 A, 29 December 1980, [in Greek].
8. A. Macridimitris and A. Passas, *The Greek Administration and the Co-ordination of European Policy*, Working Paper No. 20, Athens, Hellenic Centre of European Studies, 1993, p. 38 [in Greek].

their own independent staff and resources'.[9] Problems of internal co-ordination were naturally projected on to formal channels of inter-ministerial co-ordination; in the process, those involved opted for looser forms of co-operation, relying more on *ad hoc* arrangements.[10]

Ministers shied away, if they thought that their authority and prestige would be further weakened by sharing functions; preparatory committees were typically attended by high-ranking civil servants who had limited technical knowledge and lacked a firm EEC perspective; those who wanted to have a real input in the process had to bypass committees and build up personal relationships across ministries. Even in Brussels, the Greek Permanent Representation, which constituted the formal mediator between the national and EU levels, had been known to suffer from 'the politicisation of appointments, the consequent lack of technical expertise, the limited degree of networking within the Commission, and more importantly, the uneasy co-ordination relationship between the two Ministries'.[11] Hence, inter-ministerial co-ordination came to depend on the existence of personal channels of consultation and communication, the urgency of a given issue and whether its solution necessitated sharing the responsibility and accountability. In the case of EMU, all three conditions applied.

The Prime Minister as a broker and the role of on-going negotiations

In negotiating the Maastricht Treaty, Prime Minister Mitsotakis sought to insulate the formulation of the Greek strategy from the Cabinet, opting for an inner circle committed to safeguarding Greece's position in European integration. In the context of informal meetings, he gathered around him Efthimios Christodoulou, Minister of National Economy, Antonis Samaras, Minister of Foreign Affairs, and a few select officials. In a symbolic move, the Prime Minister had assumed the office of the Minister of National Economy during most of the IGC period (1 October 1990–8 August 1991). He wanted to signal, particularly to his European partners, that the eventual convergence of the Greek economy was his government's central priority. It was indicative of his intentions that Christodoulou, who replaced Mitsotakis as Minister (8 August 1991–17 February 1992) was previously his Alternate Minister of National Economy (1 October 1990–8 August 1991). As negotiations began, Christodoulou was entrusted with the task of supplying the cabinet with formal reports; the Prime Minister, as well as Yannis Paleokrassas, Minister of Finance, contributed with non-papers (unofficial and off-the-record presentations of government positions), whenever this was deemed necessary. The

9. Interview 7.

10. Spanou argues that the general characteristics of the political-administrative system have visibly left their mark; these include, 'a low degree of institutionalisation, a gap between formal rules and informal practices, the fragmentation and importance of personal initiatives and networks, the politicisation of recruitment at the expense of merit, and the lack of continuity'. *See* C. Spanou, 'Greece', in H. Kassim, B. G. Peters and V. Wright, (eds), *The National Co-ordination of EU Policy: The domestic level*, Oxford, Oxford University Press, 2000, p. 174.

11. Interview 6; interview 9; interview 10; interview 11; interview 12.

chapter eight | conclusion: owning and sharing responsibility

If numbers tell the truth, then the Greek sovereign debt crisis has indeed reached epic proportions. The economy has entered its sixth year of recession, public debt has climbed to 156.9 per cent of GDP, and unemployment has soared, exceeding 60 per cent among young people; worse, the adjustment process is now expected to continue well beyond the end of the forecast horizon in 2014[1]. The Athens Stock Exchange has lost almost 90 per cent of its value, major companies have relocated their headquarters and switched their primary stock listings and the number of small and medium-sized enterprises (SMEs), the 'backbone' of the Greek economy, has been reduced by 90,000 between 2008 and 2011. Amidst the turmoil, Greece is also facing a serious crisis of identity, no longer able to sustain the Europeanisation and modernisation façade of the good EMU years. The city centre has repeatedly played host to street rallies and demonstrations, during which there has been, at times, extensive vandalism: of hotels, monuments and even the parliament's grounds; public sector strikes have disrupted services; and petty crime is on the rise. Having seemingly resigned to its debtor status, Greek society is reaching breaking point – in the last two years, the suicide rate, typically one of the lowest in Europe, has jumped up, the number of homeless has increased by about 20–25 per cent and bank loans have hit a 25 per cent default rate.

Greece banked on EMU yet came close to insolvency. How did it happen that great expectations turned to dust so quickly? Following a long-drawn process of maladjustment, Greek policy makers stuck to what they knew best: they borrowed in order to finance unsustainable development; they allowed expenditure on the public sector to balloon, with meritless wage increases, benefits, and pensions; and, in the end, they generated comfortable lifestyles that were parasitic on the state – all this, at the expense of real growth and the modernisation of the economy. A profoundly distorted conception of the social contract was at work, but one that all parties appeared to be content with. Special interests of all kinds continually popped up, helping themselves to a slice of an ever-expanding pie. This catastrophic entanglement began to lose its appeal, when it became obvious that Greece would have to struggle to avoid default. The crisis could 'force' or bring about a new form of social contract. Difficult reforms agreed with the country's creditors, however, would have to break thirty year old practices of corruption, cronyism, and clientelism.

Is Greece a case of economic delinquency or a victim of systemic failure? The question and its answer have wider resonance: the Euro project – a currency

1. European Commission, 'European Economic Forecast Autumn 2012', *European Economy 7*, 2012, p. 4.

without a state – was always going to be about owning and sharing responsibility in a less-than-optimal monetary union in a more-than-troubled world. Delinquency in economic and fiscal management was rampant, well before Greece joined the EMU, and well after, as this book has thoroughly documented. However, that the country's refinancing difficulties 'triggered a systemic crisis for the euro that brought global financial markets to the brink'[2] suggests that the European monetary system itself was deeply flawed.

Weak institutional capacity and the road not taken

This book has offered an analytical narrative of how distinctive patterns of national economic-policy formation have tended to persist in the face of significant pressures to change, including entry to the EEC, EMU membership, a severe sovereign-debt crisis, and the securing of bailout loans on the basis of conditionality. Throughout each episode, the domestic institutional framework has provided for weak capacity and strong incentives regarding the creative interpretation of rules and non-compliance. In an interesting twist, deterioration in the quality of institutions has resulted from policy actors creating laws and practices that enabled and legitimated unaccountable and non-transparent behaviour. Economic policy-making was typically 'structured around the Minister and his entourage; his personality, education, and the people surrounding him were crucial to the kinds of choices he made'.[3] With 'a premium placed on personalities – Greece is not Germany, Switzerland or Britain',[4] and the absence of a strong and independent civil service, questions of accountability and responsibility did not rank highly in importance, particularly whenever a Minister enjoyed the Prime Minister's trust or friendship. As a result, setting ministry objectives and performance criteria became irrelevant over time, the performance of Ministers, most of whom were economists educated in top universities in the UK and the US, wildly variable.

Weak institutional capacity also showed in a Greek civil service which was 'not fit for purpose' – a fact that would disrupt any attempt at rational planning and strategic decision-making. Even though there were organisation charts that meticulously mapped positions and hierarchies, 'the problem was in actual operation, in achieving proper execution and in having under one's supervision people willing to work'.[5] Bureaucratic clientelism, the 'systematic infiltration of the state machine by party devotees and the allocations of favours through it'[6], formally replaced more orthodox forms of recruitment, appointment and

2. R. Baldwin and D. Gros, 'Introduction: the euro in crisis – what to do?' in R. Baldwin, D. Gros and L. Laeven , (eds), *Completing the Eurozone Rescue: What more needs to be done?* A Vox. EUorg publication, Centre for Economic Policy Research, June 2010, p. 1.
3. Interview 10.
4. Interview 17.
5. Interview 10.
6. C. Lyrintzis, 'Political parties in post-Junta Greece: a case of "bureaucratic clientelism?"' in G. Pridham, (ed.), *The New Mediterranean Democracies,* London, Frank Cass, 1984, p. 103.

promotion, both at the top – following each government turnover, a large and often fluctuating number of top administrative posts were filled by appointees of the governing elite – and at the bottom, since recruitment of employees at the lower levels and in-service transfers were typically based on particularistic criteria, such as political-party affiliation.[7] The two tended to feed off each other, with ministers routinely complaining of 'the inefficiency and lack of high calibre personnel which leads us to bring in outside people in order to assist the government with its work'.[8]

Dispensing with the grave responsibility that came with using the public sector as an employment tool did not really make sense – this was a practice that eager politicians operating in an antagonistic party system had sworn by; state employment, in fact, ballooned with every election,[9] while, following EMU accession, the bulk of government borrowing went to pay the wage bill in the public sector and on pension outlays.[10] In this 'system', rocketing costs simply served to intensify the effects of fragmentation of power, lack of co-ordination and random dispersion of (any) expertise and technical knowledge.

A 2011 OECD report recorded precisely the shortcomings of public governance in Greece, emphasising 'legal formalism' and limited attempts to introduce performance-based management of human resources. The culture and framework that has emerged paralyses civil servants, as it does not provide incentives for policy initiative; expects proposed actions to be accompanied by a legal text; privileges the observance and development of administrative processes at the expense of developing policy substance; and slows down the work of the administration.[11] As a result, 'inadequate data collection schemes and the absence of precise data' negatively affected reform strategies because they 'lack a strong evidence base which would justify, support – and quantify – effective and efficient policy decisions'.[12] The high ministerial turnover, discussed in Chapter Six, has further disrupted policy implementation, particularly as co-operation and co-ordination between and within ministries has not been dependent on formal

7. D. Sotiropoulos, 'Democratization, administrative reform and the state in Greece, Italy, Portugal and Spain: is there a "model" of South European bureaucracy?', *Discussion Paper No. 17*, The Hellenic Observatory /The European Institute, April 2004, pp. 33–4.

8. Interview 39.

9. C. Spanou, 'Elections and public administration: the electoral mobilisation of intra-administrative patronage mechanisms' in C. Lyrintzis and E. Nicolacopoulos, (eds), *Elections and Political Parties in the 1980s: Developments and prospects of the political system* (Athens: Themelio, 1990), pp. 165–99 [in Greek].

10. V. Rapanos, 'Size and range of activities of the public sector', *Working Paper*, Foundation for Economic and Industrial Research (IOBE), November 2009, p. 42 [in Greek].

11. OECD, *Greece: Review of the Central Administration,* OECD Public Governance Reviews, OECD Publishing, 2011 (accessed 2 October 2012). Online. Available: *http://dx.doi.org/10.1787/9789264102880-en,* p. 27.

12. *Ibid*. p. 9.