

spotlight europe

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Money or Democracy? Greece and the Euro Dilemma

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The negotiations on the third bailout package for Greece are still going on, but the euro area has already paid a high price for it. The compromise on which it is based is clearly very controversial. Some of its critics believe that it does not make sense in economic terms, whereas others point out that it may have an adverse political effect. But what in fact is Greece actually supposed to be doing, and what does all this mean with regard to sovereignty and democracy?

The heads of state and government of the euro area struggled for 17 hours to reach an agreement designed to reconcile Greece's financial needs with the security requirements of the creditor nations. What has emerged is a key issues paper which makes demands on the Greek government that even Federal Chancellor Angela Merkel called "harsh" in her first public statement on the subject. In this Spotlight Europe we explain the small print of the agreement and the obstacles that may yet have to be overcome before the negotiations are completed. We then turn to the question of whether or not the agreement is consonant with the democratic aspirations of the EU.

[From the Key Issues Paper to the Third Bailout Package. The Next Steps](#)

Step One – From the Conclusion of the Summit to the Start of the Negotiations: The Euro Summit came to an end early in the morning on Monday, 13 July 2015. The Greek government had until the following Wednesday (15 July 2015) to get parliament to vote on a first package of measures and to obtain its basic assent to the whole of the Key Issues Paper. The four immediate measures were concerned with VAT and pension reform, the statistics authority and the debt brake. On Thursday and Friday the parliaments in Berlin,

Vienna and Helsinki then had an opportunity to discuss the results and to give their governments a negotiating mandate, which they were able to pass on to the chief negotiators of the creditor institutions – the European Commission, the European Central Bank (ECB), the International Monetary Fund (IMF) and the European Stability Mechanism (ESM) – on Friday evening. At the same time the 28 EU finance ministers discussed the subject of a bridging loan for Greece. €7.16 billion were made available for a period of three months in order to bridge the short-term financing gap before the conclusion of a new programme that keeps the government and the economy up and running.

On 22 July 2015 prime minister Alexis Tsipras succeeded in persuading parliament in Athens to give its assent to a second list of reforms that contained a number of “prior actions.” These included the reform of the civil justice procedures and the implementation of the EU Bank Recovery and Resolution Directive that entered into force in 2014.

Step Two – Four weeks of Negotiations on a Third Bailout Package. The seven-page Euro Summit statement issued on 13 July 2015 lists quite precisely what the donor countries want the Greek government to do in the short and medium term in order to be able to provide Athens with further assistance amounting to as much as €86 billion over the next three years. Between €10 and €25 billion of this is needed by the banking sector:

- Reform of the pension system
- Adoption of ambitious product market reforms together with a clear implementation timeline (they include Sunday trade, sales periods, ownership of pharmacies and bakeries, and opening of closed professions, e.g. ferry transportation)
- Privatization of the electricity transmission network operator (ADMIE), unless, that is, it proves possible to find competition-enhancing replacement measures in the energy sector
- Review and modernization of the procedures designed to facilitate collective bargaining and industrial action, and to deal with collective dismissals
- Measures designed to strengthen the financial services sector, and especially the exclusion of political pressure in general and with regard to appointments in particular

- Development of an improved privatization programme. Transfer of valuable Greek assets to an independent fund which will monetize the assets
- Modernization and greater effectiveness of the Greek bureaucracy (depoliticization).

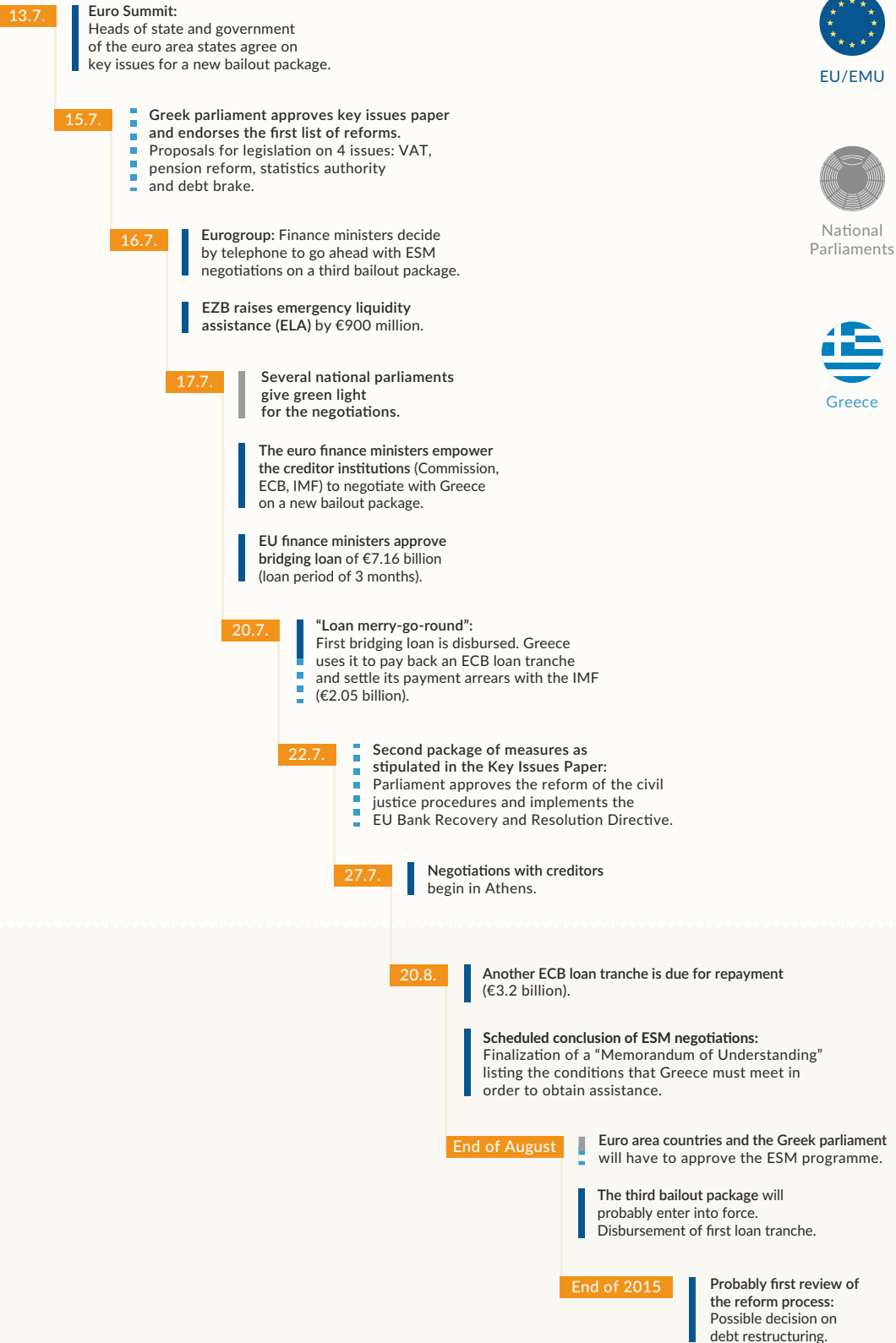
But how are these measures going to work out in practice, and what are the various timelines? These and many other questions are now being clarified in the actual programme negotiations which commenced in Brussels on 20 July 2015 with experts from the European Commission, the ECB, the IMF and ESM, the euro bailout fund. They intend to complete the negotiations, which are also taking place in Athens, by the middle of August, and to draw up a “memorandum of understanding.” This will stipulate the requirements that will have to be met in order to obtain further financial assistance.

Step Three – Ratification Must Precede Disbursement. The finance ministers of the euro area states will review the results after the negotiations have been completed. Some governments, including those of Germany, Estonia and Finland, are compelled by law to allow their parliaments to discuss and vote on any new ESM programme. Only then can the third bailout package come into force. This will probably happen at the end of August. But in the meantime the Greek government is going to have to pay salaries and service its debt. For this reason, if the need arises, another €5 billion can be added to the bridging loan, which amounts to roughly €7 billion. On 20 August 2015 a credit tranche of €3.2 billion is due for repayment to the ECB. This debt cannot be serviced without the help of the bailout package or another bridging loan.

Anger and Outrage

The negotiating marathon between Greece and the euro states has become a symbol of how difficult it is to implement bailout policies within the monetary union, and confronts the euro area with the most serious challenge that it has ever faced. There is fundamental disagreement on the shape of an economic and politically feasible solution for Greece’s problems. The criticism voiced in the wake of the Key Issues Paper was primarily levelled at Germany. It is more or less

Timeline of Third Greek Bailout Package



EU/EMU



National Parliaments



Greece

based on two arguments. One of them revolves around the question of whether or not the path that is now being pursued makes economic sense. The other maintains that the stringent conditions attached to the latest financial assistance curtail the room for manoeuvre of the democratically elected government, and that in the final analysis this means that the agreements are not democratic. Analysts agree that the size of Greek government debt is economically unsustainable. There is too much debt, and the Greek government will never be able to repay it. The IMF says this in its reports, and so does Mario Draghi, the president of the ECB.

Some commentators think this means that the Greeks should leave the euro area, at least for a few years. It is only way in which they will be able obtain a debt cut and a new currency that is much weaker than the euro. They argue that this will make it possible for them to recover their competitiveness and to get back on their feet in economic terms.

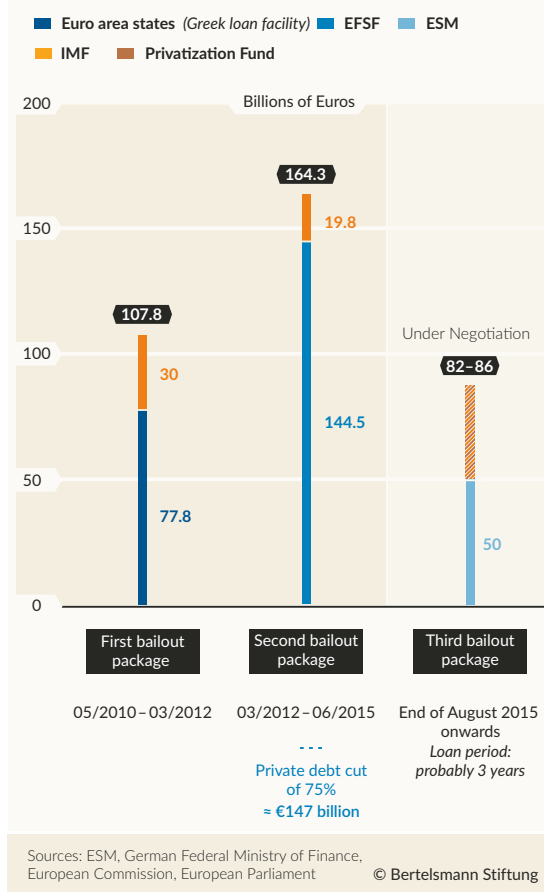
Other commentators think this means that the Greeks should keep the euro, and that what they need is a debt relief, more government investment and fewer spending cuts. These measures will kick-start the Greek economy and enable it to grow. Those who are in agreement with the second approach argue that this alone will enable them to overcome the crisis. In other words, the adherents of both approaches think there is a need for a debt cut and for something which will promote growth, either in the shape of a new “weak” currency or government investment.

At least that is what the situation looks like in theory.

Unsustainable Debt Meets No-Bailout Clause

But the monetary union is now confronted with a legal and political dilemma. First, it has adopted a no-bailout clause (Article 125 TFEU). Even if there is no complete agreement among European law experts as to whether or not a debt cut has to be interpreted as an instance of liability, there is good reason to believe that it provides enough reason to take legal action. Second, the treaties do not make provision for the withdrawal of a

Overview of Greek Bailout Packages



member state from the monetary union. Third, every government in the euro area has to justify its actions to its electorate, and not everyone is particularly impressed by the crisis management and what it has achieved.

Moreover, it has become apparent that the Greek problem is not only a macroeconomic one. It is also a problem of government. Many areas and institutions in Greece do not measure up to the standards of modern governance. There is a lack of the kind of structures that are needed by a functioning economy. However, this problem cannot really be resolved by leaving the euro area, by a debt cut, or with the help of speedy investments. There is no quick solution. The only remedy is long-term reform.

The legal and political dimension has had a decisive influence on bailout policy. This explains why only one of the immediate measures specified

on 13 July 2015 is designed to increase revenues in the short term (VAT). Two set their sights on long-term expenditure (pension reform, the debt brake), whereas three are supposed to introduce structural change (independence of the statistics authority, simplification of the civil justice procedures, bank recovery and resolution).

Thus those responsible for bailout policy are certainly attacking the root of the problem. However, they are also laying themselves open to the charge of interfering to an unwarranted extent in the internal affairs of a member state. Furthermore, the critics argue that the stringent conditionality of the financial assistance would restrict to restrict unduly the room for manoeuvre of a democratically elected government, and for this reason the agreements were basically undemocratic.

Massive Interfering in National Policymaking - But Undemocratic?

Democracy is always both: It describes a system and depicts an ideal to which one can refer when one is making certain demands. In recent years the concept has been used primarily by populist parties to criticize their national democratic systems and the European Union. Strange alliances which are supposedly motivated by democracy and a nation's right to self-determination have emerged. For example, Marine Le Pen and Nigel Farage have both praised Alexis Tsipras for his decision to hold a referendum. Similarly, #thisisacoup, which called for democracy, was a Twitter storm on a global scale. Thus the word democracy can be used as a slogan in agitation and political campaigns. But what in fact do the decisions of the summit actually mean? And are they undemocratic?

It cannot be denied that the agreement significantly curtails Greece's political self-determination and thus its sovereignty. However, the reasons for this are less conclusive. Is Greece's paralysis the result of the summit resolutions or of its debts? And when it comes to sovereignty, how much is still in the hands of the individual member states of the European Union?

Over-indebtedness always leads to a loss of sovereignty. This is true of private individuals, of businesses and of course of nations.

Whenever private individuals or businesses become insolvent, they experience a massive loss of sovereignty, or, to put it another way, they lose control over their property. An official receiver takes over to sort out the facts, to negotiate with creditors, to wind up the business and to repay outstanding debts. If at all possible, the remaining debt is repaid over an agreed period of time. The rest is waived. States cannot be compared to private individuals or businesses, and have different resources at their disposal. It is in the nature of things that over-indebtedness sooner or later visibly curtails a government's freedom of manoeuvre. In fact it leads to a loss of sovereignty even if a state still has its own monetary policy and the ability to devalue its currency. However, when this happens the loss of sovereignty harms the electorate more than it does the government. And in particular it harms people who have sufficient financial means in order to accumulate financial reserves, though not enough to invest them abroad.

The question of the sovereignty of the creditors is actually far more difficult to answer. The sovereignty of donors (no matter whether they are private individuals or governments) includes the ability to dictate the terms under which they are prepared to lend money. Furthermore, losses are part of the equation. So in the event of a default one can in theory shrug it off as one of the risks of doing business.

However, the links between the member states of the European Union in general and of the monetary union in particular go far beyond a business relationship, since a number of sovereign nations decided to introduce a common currency and thus to communitarize aspects of their sovereignty. The member states did this because they were convinced that, as Angela Merkel put it, "the advantages outweigh the disadvantages." Her new catchphrase, which currently crops up in every statement on the subject, sums up the original motivation of the member states in a nutshell, though it may perhaps be misunderstood. In point of fact it leads us to assume that we could actually "do things differently." That is of course true, at least in theory. But the alternative option available to every member state would be very expensive and rather risky. The fact of the matter is that when things are going

well all of the member states benefit (more or less), and if things are going badly we all share in the liability (more or less).

Whether one likes it or not, the EU – and the monetary union – is not a group of competing states in which factors such as the size of the territory, economic power, natural resources and military might determine who can gain the upper hand. Even if in recent years there has been a visible shift of power from the European Commission to the European Council, or in other words to the member states, in the euro area decisions are taken together. Each state has one vote, and whether its capital is called Berlin or Bratislava is of no importance. However, this also means that the democracy of one euro area nation is not superior to the democracy of another nation. In other words, Greek democracy is not superior to Finnish, Latvian or French democracy. Those who say that their democracy is superior to that of the other countries, and even if it is no more than a rhetorical ploy, are undermining the very foundations of the EU and trying to smuggle through the back door the kind of political culture which European integration was supposed to overcome.

The EU as a Community of Law

Be that as it may, the principle of cooperating states is based on yet another premise, and that is the willingness to honour agreements voluntarily. The European Union is at its core a community of law. It is in the nature of legal relations that agreements are concluded in the firm belief that the partners are willing to adhere to their provisions. *Pacta sunt servanda*, that is, agreements must be honoured, is a fundamental legal principle. Furthermore, in international law agreements between two states continue to remain in force if the government or governments of one or both countries changes. In recent months the belief that the Greek government shares these fundamental assumptions has been shaken to the core. Thus one could of course interpret the final document of the Euro Summit on 12-13 July 2015 as a reflection of the exaggerated aspirations of a number of euro countries. But one could also say that its at times ungracious tone is an expression of despair and weakness.

The history of bailout packages 1 and 2 demonstrates that the power of the creditor nations is never greater than at the point at which a decision is about to be taken on whether or not to grant a loan. It is already on the wane when the negotiations on the details of conditionality get under way, and sinks rapidly during the implementation process. At the end of the day, it is impossible to compel anyone to implement certain measures from the outside. The Greek government take ownership for them. It has to defend them in parliament and needs to persuade citizens to accept them. Its European partners can do nothing if the government has neither the will nor the strength to proceed with implementation. They can then decide to grin and bear it or to allow Greece to slide into insolvency at the next possible opportunity. The attendant risks and consequences would include government bankruptcy, the collapse of the banks, a sharp drop in economic growth and in the labour market, impoverishment, social hardships, political instability, and disintegration in Europe.

Not only the euro area countries are confronted with this dilemma. When countries join the European Union they transfer part of their sovereignty to a higher political level on which they operate together. But since – out of respect for the residual sovereignty of the nation states – they have very few resources with which to bring other EU states to heel whenever there are serious infringements of the rules, they always appear to be weak when one of the member states flaunts agreements in an aggressive manner or pays scant regard to common values. For example, the Hungarian government has on more than one occasion put its partners in a difficult situation.

It is easy to criticize the euro bailout policy and to say that it is too timid in economic terms and overambitious in political terms. However, the charge that it is not democratic cannot be substantiated. The EU is not only an economic and monetary union. It is also based on shared legal principles and shared values. Its members should be aware that fundamental agreements are not going to be called into question every time there is an election. That is not a *coup d'état*. It is a basic precondition for any kind of European action.

Risks Remain

There can be no doubt about the fact that very significant economic and political risks are associated with the bailout strategy that has now been adopted. Thus a debt cut is still a distinct possibility. The Greek debt pile has already reached €320 billion, and that does not take into account the new bailout package. The Greek debt quota has reached 175 percent and is still going up. Hitherto the creditors have officially worked on the assumption that this year Greek government debt is going to peak at almost 180 percent, and will go down to 120 percent by 2021. However, the latest IMF analyses come to the conclusion that debt will rise to 200 percent over the next two years.

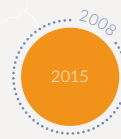
The IMF is now adamant that there will have to be a debt cut. And in Brussels there is growing recognition of the fact that if this fails to materialize, Greece will not be able to repay its debts. Even Angela Merkel recently demonstrated a willingness to think about restructured loans, about extended maturities rates and reduced interest rates. However, all this was made conditional on whether or not the first review of the third bailout package at the end of 2015 turns out to be positive. The debate surrounding a voluntary “Grexit” and debt restructuring – and of the role of the IMF in the third bailout package – will thus remain on the agenda in the coming months.

The second big question mark hovers over the actual implementation of the reforms. No government would be happy to be told that it had to go ahead with such a programme, and many would collapse under the strain. It is still unclear whether the Tsipras government will be able to resolve the internal party disagreements about the course now being pursued in order to obtain parliamentary approval for the much-needed reforms and to implement them.

Further political risks are lurking in the shadows in the other euro area states. There is mounting frustration with Greece. More and more citizens believe that the bailout policy is a mistake. Populist parties are attracting new supporters. In the coming months there are a number of important elections (in Poland, Spain, Portugal, and presumably in Greece). The outcome will give us a

foretaste of the prevalent mood in the EU in the years ahead, and of how the architecture of the euro area and its crisis policy may develop. ■

The Greek Crisis in Numbers



The Greek economy has contracted by **25%** since the middle of 2008.

Estimates say that **€70 billion** billion have been withdrawn from Greek banks over the last five years.



In 2013 **23%** of the Greek population was on the brink of poverty.



In Greece **1 out of 3 loans** is non-performing. This means that it has not been serviced for more than 90 days.

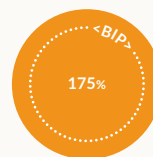


50% of Greeks between the ages of 15 and 25 are unemployed.

The Greek debt pile has risen to **€320 billion**.



In Greece **1 out of 4 SMEs** went out of business since 2008.



The Greek debt-to-GDP ratio has reached an astronomical **175%**.

Further reading:

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Christian Calliess, *Solidarität ist keine Einbahnstraße, Gespräch über Griechenland, den Euro und Deutschland*, 22 June 2015, http://www.fu-berlin.de/campusleben/forschen/2015/150622_calliess_interview/index.html.

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