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Squaring the Circle? Understanding the Legitimacy of Conditionality

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Περίληψη

Η έννοια της τήρησης των προϋποθέσεων- ως αντάλλαγμα για την παροχή βοήθειας- έρχεται στο προσκήνιο προκειμένου να αποφευχθεί ο ηθικός κίνδυνος και να δημιουργηθεί η βεβαιότητα στους φορολογούμενους στις χώρες-πιστωτές θα λάβουν πίσω τα χρήματά τους. Μπορεί όμως ποτέ να νομιμοποιηθεί 'στο έδαφος', όταν οι πολίτες των χωρών υπό διάσωση καλούνται να αποδεχτούν προγράμματα λιτότητας, στα οποία οι κυβερνήσεις τους-πόσο μάλλον τα κοινοβούλιά τους- έχουν περιορισμένη συνεισφορά ενώ τα ίδια τα προγράμματα παράγουν ύφεση και υψηλά ποσοστά ανεργίας αντί για ανάπτυξη-κρίσιμη για τη βιωσιμότητα του χρέους. Η υπό όρους χορήγηση βοήθειας πρέπει, σύμφωνα με το κείμενο αυτό πολιτικής, να προσαρμόζεται αποτελεσματικά στις εθνικές ανάγκες- ώστε να αποφεύγονται φαινόμενα πολιτικής αποσταθεροποίησης και κοινωνικού χάους, ενώ η εφαρμογή της πρέπει, κατ' ελάχιστον να διασφαλίζει τη δίκαιη κατανομή βαρών στον πληθυσμό.

Abstract

Avoiding moral hazard and making sure that tax payers of creditor countries get their money back have brought the concept of conditionality-setting conditions in exchange of financial aid- to the fore. Can it ever be legitimated on the ground, when citizens of bailout countries have to accept austerity programmes in which their governments, let alone parliaments, have had limited input and when they appear to defeat their own purpose by generating recession and high levels of unemployment rather than growth- critical for debt sustainability. Conditionality, this paper argues, needs to be effectively fine-tuned to national needs- to avoid political instability and social havoc-, while its implementation must, at a minimum, guarantee a fair sharing of burdens among the population.

Key Words:

Austerity, Bailout, Conditionality, Democracy, Legitimacy

Introduction

Can conditionality ever be legitimated? After all, it involves the imposition of typically stringent conditions, by unelected officials, in exchange for financial aid. In this respect, it meddles with national democratic processes of policy formation and policy targeting-particularly in the area of government public spending-, tends to degrade the role of parliaments to that of swiftly ratifying documents, and removes the critical element of upholding or withholding popular support from externally-induced adjustment programmes. Two interesting parameters arise here: first, conditionality constitutes a form of 'coerced' acquiescence, in the sense that the government in question is left with very little options but to accept the proposed conditions and second, for conditionality of this type to actually acquire legitimacy, acquiescence must somehow transform into 'voluntary compliance' (Scharpf, 2007); voters facing potentially life-changing circumstances (including recession, higher incidence of unemployment and reduced social benefits) have to abide to 'agreements' in which they have not been properly consulted and by which they probably stand to lose.

This is, at least, one side of the story. Conditionality would have been unnecessary, one may well argue, if governments were fiscally prudent or if they had resisted the temptation to play along with the debt-fuelled model of economic growth. Gross irresponsibility (Tsoukalis, 2011) on the part of the governments however cannot and should not breed lack of accountability on the part of the donors. There is a very real issue of how conditionality fares 'on the ground', which is typically omitted or scarcely brought up in public debate. What happens when those setting the conditions get it wrong? What if the programmes 'proposed' prescribe the wrong medicine, based on poor or misguided advice? At the very least, *conditionality must be seen to be working*, if it is to be accepted. With donors' accountability a moot point and traditional channels of accountability among governments and their citizens potentially disrupted –economic decisions that impact their lives are, after all, removed from the democratic process- conditionality must also be seen to be working *for them*. The policy paper that follows proposes an analysis of 'gaps' in the legitimacy of conditionality, at the national and Eurozone level, discussing possible remedies.

1. Closing the Gap? The National Level

-Major injustices have been committed in the name of deficit reduction and promoting budget consolidation. While the creation of a stable and equitable fiscal framework, with rules quantifying the medium-term fiscal path in binding multi-year budgets has become a typical response, what has generally been lacking is *a public commitment that the 'reformed' framework will operate for a fixed period*- no exceptions or ad hoc regulations. Voters have a right to make informed economic decisions on the basis of the (after-tax) income earned; more importantly, they have a right to know which of the 'temporary' or 'one-off' taxes will be abolished or become 'permanent'; the same applies for retrospective taxes which can reduce citizens' (and corporations') trust in the system, unless backdating legislation is used exceptionally to address artificial tax planning or aggressive tax avoidance schemes. Setting an example is always a good strategy: with citizens experiencing forced quality of life sacrifices as a result of austerity programmes, total government spending must be anchored in firm and binding expenditure ceilings; in this way, the damage done to the social fabric by previous over-spending (with the creation of unsustainable lifestyles and the wasteful transfer of public funds into undeserving beneficiaries) can begin to be rectified. In an ongoing reform process, *governments need to visibly link their efforts with both an appropriate distribution of tax burdens*- ensuring that certain sections of society are 'sheltered' (and not just those living at the poverty line)- and improving the quality of public services. The prevalent conception- a primary budget surplus is the panacea to all evils- will simply not work, particularly in countries, where the record of taxpayer compliance is mixed, creating a de facto imbalance in burden sharing.

- Tax evasion lies at the heart of equity and efficiency failures- with 'conditionality' expected to promote good governance and economic efficiency. Allowing for the adverse recession effects- forcing workers to make a living on the black market economy, burdening the social security systems with unemployment benefits and reducing income tax and corporate income tax revenue, the culture of voluntary compliance with regulation has predictably, in countries with inefficient tax administrations and unstable penalty systems, not been working. The major danger in keeping up with 'conditionality' is creating 'new' institutions or agencies and supposedly investing them with 'political autonomy' in tackling tax evasion, when, in reality, finance ministries maintain in place a system of weak tax governance (weak incentives for compliance, combined with understaffed and under-resourced agencies). No new structure for increasing tax revenue will work under circumstances where hiring is political, co-ordination between it and penalty-enforcing agencies is low, and measures for tax collecting are not targeted- indexed on the basis of 'urgency', that is timely/immediate enforceability of payments and size of payments. When tax collection is consistently sub-optimal, embedded in a political culture where the avoidance of penalties detected is high, the best possible strategy is for the government *to act pre-emptively* and *minimize tax evasion opportunities* at various levels of economic activity. This involves targeting persistent categories of tax evaders, typically the self-employed, small business, and sole proprietorships, introducing anti-avoidance rules that 'bite' automatically and cutting down on loopholes and exemptions, which augment the ability to evade. Casting the net wider, it also calls for limiting the use of cash for a range of transactions-the technical possibility created by IT systems of matching electronic payments with declared income can work as a deterrent, particularly if the tax evaders become persuaded that it will work. Governments should seek to re-examine the number of tax reliefs existing to encourage investment against quantifiable tax revenue earned, while dispensing with tax amnesties. For all the favourable reviews, a simple system of tax governance delineating clear lines of accountability will not be sufficient on its own - officials with poor records of auditing and persecuting need to be publicly reprimanded and removed from their positions. Public perceptions of the fairness of the system and its operation are, in fact, critical for meeting the expectations of citizens burdened by continuously rising taxes and by shrinking welfare state provisions. Equality of treatment goes a long way to bridging the gap between government obligations under adjustment programmes and citizens' broader acceptance of the fiscal consolidation effort.

-Structural adjustment cuts deep into national policy formation, as it theoretically generates a fundamental re-orientation of the role and size of the state in the economy. It is fair to refer to a 'standard' structural adjustment model- one only need to read through the economic programmes of Greece, Ireland, and Portugal (European Commission, 2012)- which takes little note of conditions on the ground, including the institutional capacity to deliver and whether a social and or political consensus exists. There is, conceptually at least, an antidote; 'country ownership' of reforms is held to pass implementation on to the hands national governments, hence ensuring the democratic character of often painful cuts, including the slashing of pensions and the minimum wage-hence, lack of or limited 'country ownership' can be easily blamed policy failure, whitewashing external responsibility. In programme countries, previously politically unheard of reforms have been undertaken with varying degrees of success in public administration, health and pension systems, competition frameworks, industrial relations, labour markets, energy markets, network industries, service sectors and in the regulated professions. Getting the laws passed and putting the new rules in effect have been typical responses-actual implementation, however, has habitually stumbled upon very national calculations of what is politically feasible. Moving beyond that requires a major leap forward, involving visible improvement in both the countries' growth prospects- a difficult feat, as structural adjustment effects take root in a rather long-term framework-and in citizens' appraisal of whether equity and efficiency have been promoted; hence, *governments need to design measures with a goal to reduce rent-seeking and fight vested interests' distortion* in product markets- making sure, for example, that labour cost competitiveness gains pass into price competitiveness gains. Reduced services, rising unemployment, job insecurity, lower social spending- the short-term effects of structural adjustment- must at least be balanced out with a major public campaign to fight corruption in various interfaces of citizen-public agencies' interaction, to control inefficiency in service delivery and, as a result, really shelter the most vulnerable. Horizontal measures are detrimental in this respect, while efforts must be made to introduce a scale system in the apportioning of social and health services and unemployment benefits. Only if corruption and legal complexity are seriously cut back, a level-playing field is created- dispensing with capture, patronage, and clientelism- and a stable tax regime instituted, can the business environment bounce back and public trust be restored. To this end, governments are well advised to consider, in the design of their programmes, both traditional sources of government failure (to avoid repeating them) and good practices, at local or national level to adopt.

-'Conditionality' is a heavily laden concept, revoking images of reforms being imposed from above; ignorance about its logic exacerbates the negative connotations of its intrinsically top-down approach. What is at stake, therefore, is the development of a fair narrative of conditionality, one that explains the obligations that inadvertently come packaged with a loan; for one, 'conditionality' is meant to act as a 'guarantee' against the prevalent criticism that bailouts can actually contribute to crisis by creating moral hazard. While governments cannot appeal to this argument- it would amount to political suicide- *they can be more vocal about having the opportunity to re-shift their growth models*, from domestic demand toward investment and market expanding exports. Revamping domestic economies that failed and having a scapegoat to do so is not a bad deal politically. After all, gains and losses in political legitimacy in contemporary liberal democracies have largely been associated with the ability (or lack of) of governments to create jobs with acceptable wages, promote sufficient economic growth, and maintain a decent welfare state.

2. Bridging the two zones, 'core' and 'periphery'

The relationship between governments and their electorates is not the only one currently being affected. Imposing conditions externally comes with further costs, particularly for members comprising a less than perfect monetary union. The open and very public division between creditor and debtor countries is hardly conducive to legitimising conditionality, particularly when 'who is to blame' questions often fail to consider the very substantive divergences in the competitive positions and current-account balances that were allowed to build up over the last decade (Pisani-Ferry, 2012) . At this critical stage, *gaining a sense of a 'union' vis-à-vis the Eurozone crisis is imperative to both guaranteeing the cohesiveness and legitimating the European project*.

-Swallowing the bitter austerity medicine and the conditionality that goes with it has been an essentially asymmetrical process. Burden sharing has been absent, with deficit countries expected to fight recession (or low growth), unprecedented rates of unemployment, and worsening debt burdens for the greater good of saving the single currency. Even if progress has been made- external imbalances have improved and unit labour costs have come down-, this is, in the long-run, an unsustainable situation; the internal devaluations that have been under way cannot be expected to last forever, particularly as surplus countries refuse to undergo devaluations of their own, through rising prices for example. This asymmetry in effort insults both the people of the deficit countries who have been experiencing severe and sustained attacks on their income and their political systems as they crumble under the weight of budgetary consolidation. The answer that has been proposed, strengthening economic and budgetary co-ordination, through more fiscal tightening and bigger sanctions, falls short of a monetary union intent on ensuring that policies are responsive to the preferences (Follesdal and Hix, 2006) of all its members, equally and with equal respect. Co-ordination in this respect should acknowledge the distributional implications that some states and their citizens have been forced to absorb on account of EMU design and lack of fit. *To avoid the de facto creation of a two-tier citizenship across the union, conditionality must be offset with a co-ordinated response of both deficit and surplus countries*, proposing a fairer adjustment of intra-euro-area competitiveness and macroeconomic rebalancing.

-At the same time, tax payers in the north feel that they are also being by-passed, as their political leaders have authorised one bailout programme after another. A sense of lack of control over the democratic process is made worse by the mixed if not shaky results of the bailouts; worse, the politics of austerity seem to be taking hold in the core- complete with the new economic orthodoxy that cutting government spending is the key to restoring or maintaining investors' confidence. European elites purport to legitimise the process by invoking conditionality (Draghi, 2012) and by creating a new set of rules on enhanced EU economic governance. This amounts, for citizens in debtor and creditor countries alike, to transferring more powers to Europe without treaty change (which would at least involve the consent of member states and the derivative compliance confirming it) or some other form of binding citizen endorsement, including national referenda (which have had a rather poor showing in the history of European integration). *In the absence of a credible narrative of solidarity, footing the bill for the debt of insolvent countries makes little sense. Without a clear road map for an inclusive and symmetrical 'Europe', for the equal sharing of benefits and responsibilities, one which goes beyond market appeasement and keeping the faith in some abstract integration cause, dispensing with national sovereignty in fiscal policy-making and undergoing painful reforms makes little sense.*

Conclusion: Ignore at your own risk

There is a clear and present danger that Eurozone authorities and national political elites keep ignoring to (possibly) their own peril. Unless the legitimacy of conditionality is embedded in a new social contract in Europe- one that unites the 'core' and 'periphery' in burden sharing-, and unless new constraints are offset with positive incentives for belonging in something bigger than a single currency without a state, the Eurozone crisis will pale in comparison to the democratic crisis that will blow up, both within the member states and right across 'their' monetary union. For better or worse, the Eurozone crisis already points to how national political leaders operating in a 'fragile' monetary union (De Grauwe, 2011) have let their citizens down. Following the growth 'miracle' of the early EMU years and the illusions of grandeur- of upward economic and social mobility- that were cultivated, through credit-fuelled booms and increased social transfers, citizens are now experiencing the bad end of the deal; no one disputes, of course, that they voted for the very governments whose political mismanagement, ignorance and inability to regenerate or build up their states' low institutional capacity lie behind the failure to tackle problems of competitiveness, productivity and growth. Austerity politics, however, is generating a very serious redistribution of income, posing the question that lies at the heart of liberal democracy: *how are citizens supposed to have equal rights and enjoy equality of citizenship when, in reality, they are de facto being set apart by increasing economic inequalities?* European and national elites who choose to ignore this growing sense of inequality or pretend that it is not making inroads across the entire Eurozone (with politically extremist side-effects finally catching up with the 'core') do so at their own responsibility. A two-tier European citizenship or widespread non-compliance with the current unfortunate set-up will be the death knell of any legitimacy that the European project still holds.

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About the Crisis Observatory

In the context of the worst economic crisis in the history of post-war Greece and the wider European debt crisis, initiatives for the systematic and scientific documentation, study and analysis of the crisis in both Greece and Europe are sorely needed.

The Crisis Observatory aims to answer this call. The Crisis Observatory is an initiative of the Hellenic Foundation for European and Foreign Policy (ELIAMEP), with the support of the Stavros Niarchos Foundation.

Its primary objective is to become a central hub for information, research and dialogue for both the Greek and European crises. The Crisis Observatory's guiding principle is the presentation of new research, policy proposals and information, which are based on solid arguments and empirical evidence, with a view to improving the level of public discourse about the crisis. In order to achieve this objective, the Crisis Observatory's work is organized around three central pillars:

- The provision of educational material with a view to enhance the ability of the average citizen, who often does not have a good hold on economic issues, to understand basic parameters of the crisis.
- The provision of serious, evidence-based and representative, in terms of subject focus and theoretical/political approaches, information about the crisis.
- Intervention in the public discourse about the crisis, through the creation of a venue for the free expression of different views and policy proposals promulgation of new research about the crisis.

The team of the Observatory is:

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