Accounting for variation in the impact of and response to economic crisis in Southern Europe: institutional performance and policy learning capacity in Greece and Portugal

-DRAFT-

Christos J. Paraskevopoulos
Associate Professor of European Public Policy
University of Macedonia,
Egnatia 156, 54006
Thessaloniki, Greece
Tel: +30 2310 891419
+30 210 9750937
Email: chrp@uom.gr
chrp@otenet.gr

Paper prepared for presentation at the
6th ECPR General Conference, Reykjavik, 25-27 August 2011
Section ID: 58
Crisis Zone? State Quality and Democratic Quality in Southern Europe
Panel: Post-Crisis Public Policy Reform in Southern Europe
Abstract

Greece and Portugal are widely considered as similar and comparable case study/representative countries of Southern Europe, characterized by the combination of centralized state structures and rather weak civil societies. Hence, the presence of major adaptational pressures in almost all policy areas is considered a crucial challenge facing the two countries since their accession into the EC/EU. Yet, increasing evidence from several policy areas over the last two decades may point to a different direction: namely that, despite the presence of important similarities, there seems to be significant variation in institutional performance and policy learning capacity among the two countries. This has become particularly evident recently in relation to the response to the current economic crisis.

In light of the above, this paper, drawing primarily on the institutional theory of Europeanization and taking into account the rather soft-handed approach to policy implementation on the part of the EU Commission, concentrates on the dynamics of the domestic level of governance in the two countries. Thus it explores, in a comparative perspective, the crucial interplay between institutional performance, learning capacity of domestic institutions and policy implementation. Within this theoretical framework, the paper, based on evidence from macro-economic adjustment and cohesion policies, examines crucial aspects of the domestic institutional infrastructure, such as the level of corruption, rule of law, social capital (social and institutional trust), quality of government and so on, and evaluates the level of both institutional and policy adaptation in the two countries. Additionally, the paper analyses and tries to explain the response strategies adopted in the two countries over the last two years with regard to the current economic crisis. Finally, it draws some conclusions about the variation in institutional performance and policy adaptation, with emphasis on the economic crisis.

Keywords: Europeanization; policy learning capacity; institutional performance.
Introduction

Southern Europe came to be viewed as one of the main loci of the debt crisis that affected the Eurozone as a repercussion of the financial crisis and recession that began in 2008-09 and is viewed as the worst experienced by the developed democracies since the Second World War. Yet, while the international crisis itself is considered as an outcome of the institutional foundations/architecture of the neo-liberal era of the last 30 years -manifested itself primarily in the form of poor international economic governance of globalization, especially in the areas of regulation of financial markets and the ever increasing levels of economic inequality and inequality of opportunity (see Hall, 2011), the crisis facing the Southern European countries is actually further exacerbated by the poor/doomed to failure construction of EMU. In particular, the outbreak of the international economic crisis revealed the fundamental institutional weakness of the EMU, namely the weak institutional formulas for effective and efficient coordination of economic policies, mainly in the form of the Growth and Stability Pact (GSP), which was supposed to be the institutional foundation/replica for safeguarding the Maastricht criteria. In that respect, notwithstanding the impact of the international crisis on triggering the crisis in Southern Europe, the latter should/has to be dealt with at the EU level itself. In other words, the debt crisis of the EU periphery in general and Southern European countries in particular can be considered as a crisis in waiting, which has actually been triggered by developments at the international environment/level (regime), notably the outbreak of the international financial and economic crisis. In that respect, this crisis may have serious consequences for/affect the EU system of governance in several respects.

Nonetheless, although there are good reasons for putting/viewing the Southern European countries as belonging to the same region (i.e., common features of institutional evolution, democratization, modernization, developmental paths and so on), there is actually significant variation between them. This became evident even recently in relation to the intensity of the economic crisis, with Greece facing the most serious consequences, i.e. being on the brink of total collapse/default over a long period of time, and hence being considered as the weakest of the SEU weak links, mainly because of its huge debt burden. Portugal, on the other hand, followed later on, joining Greece and Ireland in asking the financial support of the EU and the IMF in the form of EFSF, and signing Memorandum of Understanding (MoU), though because of a different reason, namely not so much because of its debt burden as because of its low competitiveness over a long period of time. Finally, Spain hasn’t any serious debt problem, but rather a problem of property boom that has caused problems to its banks.

Thus, the paper concentrates on the impact of Europeanization on domestic governance and policy structures and the response of the latter in terms of adaptation and adjustment, and examines the possible variation in the evolution of the adaptation and adjustment processes to the pressures of Europeanization in two comparable case study-countries, namely Greece and Portugal. Indeed, both countries are unitary and centralized states of almost the same size and were part of the so-called third wave of democratization of the 1970s (along with Spain). However, although their democratization and/or modernization processes demonstrate important similarities, in such a way that they could be considered as absolutely similar cases, as we’ll
show, they may vary marginally, though crucially, in several respects. Additionally, both countries up until the outbreak of the financial crisis had been experimenting with serious reforms in several policy areas, most importantly in areas linked to the improving of their economic competitiveness and achieving socio-economic cohesion. Hence the paper concentrates on the interdependent and interrelated areas of macroeconomic adjustment and cohesion policy. Yet, given that it is very difficult to attribute the post-crisis policy reforms to any well-constructed/design plan for policy reforms on the part of the governments, the paper takes brief stock of the evolution of pre-existing policy structures and outcomes of the post-EU accession period, as well as of the latest post-crisis phase, although it might be too risky to draw conclusions from this period, because of limited evidence from implementation of reforms.

In that respect, the first section discusses the *problematique* of the interaction between the increasing Europeanization of public policy and domestic adjustment processes with emphasis on the particularities of the current era of economic crisis and establishes the research hypothesis of the paper. The second section attempts to identify the existing variation in the areas of macroeconomic/structural adjustment and cohesion policy. The third section attempts to account for/explain the existing variation and to codify the crucial characteristics/features of the institutional infrastructure of the two countries that can contribute to the codification of the countries themselves as paradigmatic cases, if possible. Finally, the fourth section draws the main conclusions with regard to the existing variation between the two countries and summarizes the main lessons drawn for policy reform and policy adjustment for other SEU countries.

**Europeanization and the economic crisis: domestic adjustment in difficult times**

The Europeanization process is often viewed as a powerful tool driving institutional and policy reform in both countries and Southern Europe in general, since its impact is linked/has coincided with the post-authoritarian transition in these countries. Hence, it is also closely associated with the modernization process. Additionally, both processes are intrinsically linked to the *problematique* of governance in the EU, whereby the member states are facing the challenge to adapt their institutional and policy-making structures to a multi-layered policy-making environment. In particular, the notion of ‘multi-level governance’ in the EU (Marks 1993; Kohler-Koch 1996; Caporaso 1996; Marks et. al. 1996; Piattoni, 2010) implies that sub-regional, regional, national and supranational authorities interact with each other in two ways: first, across different levels of government (vertical dimension); and, second, with other relevant actors within the same level (horizontal dimension). Given, however, that the notion of Europeanization may take several meanings and refer to a wide variety of processes, (that is historical, cultural,

---

1This is particularly true in the case of Greece, where, since its emergence on the domestic political arena and public policy discourse in the 1990s, the notion of modernisation has not always been clearly defined, thus taking several connotations and meaning different things to different people. In particular, the ambiguity with regard to the content of modernization in public policy is related to its interpretation—often used in public policy analysis—as an one-way process of irreversible change leading towards the predominance of a specific paradigm in public policy-making through the homogeneity of preferences and hence towards achieving overall convergence of public policy styles in the long run. On the contrary, however, modernization may take several meanings/interpretations, i.e., modernization through market; through hierarchy/central state bureaucracy etc., and, therefore, there is always a need for its content to be clarified and made specific (Hood 1998:194-221). For, in the contextual framework of Greece and probably other SEU countries it should primarily be interpreted as synonymous to institution building.
institutional) (Olsen, 2002; Featherstone 2003) and therefore there is a need for clarification, in the context of public policy-making Europeanization is primarily viewed as a process of institutional and policy adaptation as a response to EU policies, but also as the process by which national policies are transferred up to the European level and become the objective of collective decision-making processes (Paraskevopoulos and Leonardi, 2004). This dualism in the meaning of Europeanization reflects the functional discrepancy between policy formulation and policy implementation, both dominated by the “principal-agent” model, which constitutes a powerful conceptual tool in modern public policy analysis (see Hix, 2005 *inter alia*). The former implies delegation of power and authority –and hence pooling of sovereignty- about policy design to the supranational level of governance, and more substantially to primarily technocratic bodies, notably the EU Commission. That is why it may be called “bottom-up” Europeanization. Conversely, the latter refers to as “top-down” Europeanization, and involves the key role of supranational institutions, and most notably the Commission, primarily through oversight, in policy implementation along with member states. Yet in both processes member states and in particular their institutional infrastructures play an important role in EU public policy-making. Thus, the Europeanization process refers to the complementary notions of opening up the structures of the traditional nation state to informal and formal rules originating from the supranational level, and, consequently, to their adaptation to the EU multi-level system of governance. In that respect, it constitutes a rather enduring and long-standing challenge for the administrative structures of the member states and hence it is viewed as a positive external shock for promoting institution-building, learning and policy-making innovation at the domestic level of governance.

Nonetheless, in the conceptual framework of this paper we employ the “top-down” notion of Europeanization: that is we are concerned about policy implementation in both policy areas. Thus, in macroeconomic/structural adjustment policy Europeanization implies the macroeconomic adjustment of member states as a consequence of successful coordination of economic policies -broadly conceived- at the supranational level, given the lack of common economic policy at the EU level. In that respect, areas of concern here may be the problematic functioning of GSP as a tool for coordination of macro-economic policies, which is partly associated with the soft-handed approach to policy implementation on the part of the Commission and the intergovernmental character of the ECOFIN (see *inter alia* McKay, 1999; Blavoukos & Pagoulatos, 2008; Krugman, 2011; Hall, 2011). Additionally, in cohesion policy – and especially in the cases of Greece, Portugal and the other SEU countries- Europeanization is linked to the crucial role of the policy as an indirect form of redistribution –actually a substitute for the direct fiscal transfers which are common feature in federal states for tackling the asymmetric shocks (McKay, 1999; Krugman, 2011). Indeed, this function of cohesion policy is free of the risk of the so called “moral hazard” effect that characterises the typical fiscal transfers (see Paraskevopoulos, 2001, 2005, 2008...). In doing so, however, cohesion policy affects and challenges well-established structures within the domestic systems of governance and plays an important role in the administrative restructuring and devolution processes within the member states by enhancing the institutional capacity at the sub national level. In particular, its impact on the regional and local policy-making arenas is supposed to be twofold: a direct one, by providing increased resources through redistribution and a new set of rules and procedures for the formulation and implementation of development policies; and an indirect one, by shaping intra-regional interactions and thus promoting local institutional capacity through the creation of intra,

Yet, given the complexity of the multi-level governance structures within which the adaptation process takes place and the distinctive character of the policy-making structures at the EU level\(^2\), the degree of ‘adaptational pressures’ facing domestic institutions and policy-making structures in order to comply with the European rules and regulations in public policy is especially high in unitary and centralised states like Greece and Portugal. However, the presence of a high degree of adaptational pressures constitutes a necessary but not sufficient condition for domestic institutional and policy change. Indeed, there is evidence to suggest that the latter is crucially conditioned by the presence of specific institutional structures at the domestic level of governance that may facilitate or inhibit the adaptation process (Börzel and Risse 2000; Paraskevopoulos, 2001, 2004, 2005, 2008; Paraskevopoulos et.al., 2006). In other words, although the Europeanization process plays a key role in the transformation of the domestic systems of governance in general and the public policy-making structures in particular, domestic institutions and especially specific features of the pre-existing institutional infrastructure at the national and sub national levels of government matter for adaptation (Jeffery 2000; Paraskevopoulos, 2001; Risse et.al, 2001; Börzel 2001; Keating et.al., 2003). Therefore, specific features of the pre-existing domestic institutional infrastructure constitute a crucial intervening (or independent) variable between the Europeanization and domestic policy and institutional change that can account for the pace of Europeanization process.

There are two broadly different mediating mechanisms/logics in the new institutionalist literature that can account for domestic institutional and policy change as a response to Europeanization: the rational choice and the sociological (see inter alia Börzel and Risse 2000). The former is based on the ‘logic of consequentialism’ and points to the role of redistribution of resources and subsequently differential empowerment of actors at the domestic level. Thus, it conceives of important institutions for the domestic policy-making arena the presence of multiple veto points and existing formal institutions as crucial mediating factors that affect domestic actors’ capacity for action and hence policy and institutional change. This process has been conceptualised as ‘single-loop learning’ (Argyris and Schoen 1978), whereby actors acquire new information, alter strategies but they pursue given, fixed interests. The latter focuses on the process of social learning as a fundamental mechanism of domestic change and identifies networks (either epistemic communities, or advocacy and/or issue-specific) and informal institutions, namely political and organisational cultures and social norms, as ‘thick’ mediating mechanisms that affect actors’ preferences through the ‘logic of appropriateness’, leading to the re-conceptualisation of their interests and identities and thus facilitating the learning and socialisation processes (Risse et. al. 2001; Checkel 2001). In other words, the process of social learning emphasises the role of experts in the policy process as policy-change entrepreneurs through their increased capacity for the diffusion of new information and knowledge (Hall 1993) on the one hand, and informal conventions, namely social norms, as ‘glue providers’ for the re-

---

\(^2\)Although significant variation from one policy area to another is considered as the main feature of the EU policy-making structures and practices, it has been argued that the EU institutional structure is more federal than unitary and its policy-making processes more pluralist than statist (Schmidt 1997). In that respect, it has been predicted, that the more centralised and unitary member states is likely to face stronger adaptational pressures than the decentralised and federal ones (ibid.).
stabilisation of the relations among actors involved in the learning process, on the other (see Paraskevopoulos 2001, 2005). Thus, ‘single loop’ learning is significantly affected by the intended and unintended consequences of the redistribution of power and resources between the supranational, national and subnational levels of government within the EU, and subsequently by the degree of decentralisation and administrative restructuring of the state. Social learning, on the other hand, implies a continuous loop of interaction in that compliance with the EU policymaking norms and regulations is achieved through the transformation of actors’ identities and interests that the changes of the broad institutional environment bring about (Checkel 2001). As is obvious, this differentiation corresponds to the broader distinction [within the academic debate about how ‘paradigm change’ occurs in public policy] between interests, ideas/norms and institutions as fundamental conceptual tools/variables affecting change in public policy styles in general (Hood, 1994).

Additionally, given that time and space constitute crucial variables affecting the learning process (Rose 1993, 2002), they contribute to another –beyond the ‘single loop’ vs. ‘social’- conceptual dichotomy within the theory of learning, that is: learning across time and space. While ‘learning across time’ refers to the process by which lessons are drawn from the past (that is from one’s past successes and failures), ‘learning across space’ implies the drawing of lessons or policy transfers across/from other jurisdictions: either from within the same country, or from other countries or regions. Thus, while it is clear that learning across time for Greece and Portugal should refer primarily to the post-authoritarian period, learning across space is overwhelmingly marked by the tendency/willingness towards policy transfer from other EU and/or SEU countries. In a similar vein, there is a potentially crucial negative or positive role of the outbreak of economic crisis in inhibiting or facilitating the learning and adaptation processes. On the one hand, the economic crisis may exacerbate the already difficult reform process in SEU countries, while, on the other, the economic crisis may play a positive role as an external shock increasing the expediency/pressure towards reform, adaptation and adjustment.

Within this theoretical framework, this paper emphasises the role of formal and crucial informal institutions in the learning and adaptation processes. Thus, its research hypothesis is based on the assumption that administrative capacity or the quality of government is the most crucial variable affecting the learning capacity and therefore the adaptation and adjustment processes of the domestic level of governance. Administrative capacity, however, depends crucially on the quality of the pre-existing institutional infrastructure and the presence of crucial social norms, such as cooperative culture and, notably social capital. Therefore the latter constitutes the independent variable within the research hypothesis of the paper.

[Figure 1 about here]

3 The impact of the 1988 reforms of the Structural Funds on the redistribution of power between the levels of government, by strengthening the role of the subnational level and establishing direct linkages between supranational, national and subnational authorities through their role in managing and monitoring Operational Programmes (OPs) of the Community Support Frameworks (CSFs) may be seen as a characteristic case of unintended consequences initialized by institutional or policy reforms at the EU level. Moreover, the core of these reforms remained almost unchanged even after the 1993 reform put forward after the negotiations over the 1994-99 Structural Funds programme (see Pollack 1995).
Public policy evolution and response: identifying variation

Although policy cycles in the two countries in both policy areas may be seen as converging over time, i.e. expansionary policy during the first post-authoritarian period to be followed by Cavaco Silva’s market liberalization reforms of the 1980s vis-à-vis Greece’s continuation of the expansionary path etc. in macroeconomic policy, (see Pagoulatos, 2004) and reluctant decentralization and experimentation with new modes of governance in Cohesion policy (Paraskevopoulos 2004; Paraskevopoulos et. al., 2006; Nanetti et.al., 2004), there are rather marginal, though crucial, features/characteristics/differences dominating the post-authoritarian period in the two countries in both policy areas that can justify the presence of variation in public policy structures. This section concentrates on identifying this variation per policy area.

Macroeconomic adjustment

Even though the doomed-to-failure design of EMU along neo-liberal lines with no provision of institutional mechanisms for the long-term coordination of fiscal policy across Europe gave impetus to a strategy of competitive deflation thus exacerbating the north-south divide in Europe but also providing relative stability and cheap credit to SEU countries in general and Greece and Portugal in particular (see Hall, 2011) may be seen as the common ground that led both countries on the brink of collapse and default over the last year, there is a Greek paradox pointing to different direction. And this is how a country that enjoyed the highest levels of growth among SEU countries over more than a decade can be the typical laggard and the weakest link in Europe struggling to survive a total collapse and default. Yet, in fact, this phenomenon is actually indicative of the existing gap in macroeconomic performance between Greece, Portugal and Spain over the last 15-20 years or so, especially in terms of fiscal and current account deficits and public debt (see figs 2-6).

[Figs 2-6 about here]

Thus, the 2008-09 global financial crisis merely exposed Greece’s vulnerabilities. Significant overspending and a sharp fall in government revenue pushed the general government deficit to 15.6 % of GDP in 2009, while government debt reached 115 % of GDP at the end of 2009. Moreover, the extent of the deterioration in the fiscal position was revealed with some delay due to serious deficiencies in Greece’s accounting and statistical system. Delays in the implementation of corrective measures disconcerted financial markets, which began questioning Greece’s fiscal sustainability. Rating agencies downgraded the sovereign, and the yield on sovereign bonds and CDS spreads increased significantly (CEC, 2011a,b,d). Following a further worsening of market conditions in the course of April 2010, in May 2010, the Eurogroup agreed to provide bilateral loans pooled by the European Commission for a total amount of € 80 billion, to be disbursed over the period May 2010-June 2013. The financial assistance provided by euro-area Member States was part of a joint package, with the IMF financing an additional € 30 billion under a Stand-By Arrangement. This financial assistance package was designed to fully cover the government’s financing needs related to its fiscal deficit and all its maturing medium- and long-term liabilities until the beginning of 2012, and progressively less thereafter. However,
due to the settlement of unforeseen arrears accumulated in the past, the debt maturing within the programme period has increased. The Greek state has also accumulated new arrears. As market access remains limited to short-term market financing and the regaining of long-term market access in early 2012 is now unlikely, the programme has become underfinanced. A revised reform package — including an ambitious €50 billion privatization plan — was adopted by the Greek Parliament on 29 and 30 June. Against this background, and on the basis of the debt sustainability analysis by the Commission and the IMF, Eurogroup ministers approved the disbursement of the fifth tranche of the current Greek Loan Facility (amounting to €12 billion, of which €8.6 billion from euro-area Member States) on 1 July. In addition, private sector involvement is being sought through voluntary rollovers of maturing Greek debt. All this prepares the ground for a second programme, which will be financed from both official and private sources, as agreed by the June 2011 European Council (CEC, 2011a,b,d). Finally, building on the comprehensive policy package, discussions on the financing modalities for Greece’s economic programme took place in June and early July 2011. End June, the Greek Parliament adopted a set of key laws on fiscal and economic reform strategy and privatization. This paved the way for the approval by the Eurogroup and the IMF’s Executive Board of the disbursement of the July installment under Greece’s first financial assistance programme.

With regard to structural reforms there are two crucial policy areas involving SEM issues but also bordering on Cohesion policy and the Lisbon agenda in particular that are predominant in the public debate and the reform plan itself: first, the so called “remnants of protectionism”, that is issues related to the opening up of crucial sectors of the economy/markets, such as the area of transport (i.e. cabotage), education (i.e. recognition of professional rights to non-state college graduates), pharmacies etc., through the removal of barriers in Greece; and second, issues related to the flexibility of labour market and/or avoiding/tackling social dumping vis-a-vis other member states in the EU of 27. While the former is viewed as a crucial challenge facing Greece in relation to the modernization and adaptation processes, the latter is linked to the lack of a common model/regulatory regime at the EU level of governance in terms of labour market and social protection system, and therefore to the existing variation among EU member states. Thus, given the crucial role of labour market and social security/protection regimes within the reorientation of the main development goals and objectives of the Greek economy, as formulated by the National Strategic Reference Framework (NSRF), towards greater competitiveness through innovation at the level of global economy, this issue goes beyond the boundaries of social policy and touches upon the main development challenges facing the country and most importantly the achieving of real competitiveness at the global level. As it is obvious, this debate has become much more relevant and timely more recently under the pressure from the current economic crisis facing Greece. In that respect, the cornerstones of reorientation process of development and cohesion policies are the continuation of structural changes in the framework of the single market, the country’s economic integration and the restructuring and modernization of the public administration at all levels of government.

What has to be stressed, however, is that partisanship, extreme polarization and fierce resistance to change have been the dominant features of the political climate over the last year or so in Greece, with the legislation surrounding the MoU and all relevant structural reforms package actually passing through parliament only with the governing party (PASOK) and without any
political consensus. As we’ll see this is a potentially crucial difference with Portugal where the two major parties actually support the reform process.

In the case of Portugal, unfavourable fiscal developments and a bleak outlook for economic growth led to a deterioration of confidence and rising pressures in sovereign bond markets in early 2011, culminating in Portugal’s request for official assistance. In parallel, the banking sector, which is heavily dependent on external financing, became increasingly cut off from market funding and resorted extensively to Eurosystem funding. The government stepped down after failure to gain parliamentary approval for the Stability Programme in late March 2011. In the wake of consecutive downgrades of Portuguese sovereign bonds, interest rates reached levels that were no longer compatible with long-term fiscal sustainability. Following the formal request for financial assistance made by the Portuguese authorities on 7 April, the terms and conditions of the financial assistance package were agreed by the Eurogroup and the Ecofin on 17 May 2011. The financial package covers Portugal’s financing needs of up to €78bn. The European Financial Stabilization Mechanism (EFSM) and the European Financial Stability Facility (EFSF) will provide up to €52bn (€26bn from each), to be disbursed over three years. Further support will be made available by the International Monetary Fund (IMF) for up to €26bn under an Extended Fund Facility. The EFSM loan will have a maximum average maturity of 7.5 years and a margin of 215 basis points on top of the EU’s cost of funding. For the EFSF, a margin of 208 basis points, as well as the costs of its cash buffers, is added to the EFSF cost of funding. This yields conditions similar to those of the IMF support. The aid is being provided on the basis of a three-year policy programme for the period up to mid-2014. It includes a banking support scheme of up to €12bn to provide the necessary capital in case market solutions cannot be found (CEC, 2011a,c).

With regard to structural reforms, they cover a wide range of areas, including the labour market, the housing market, education, energy, transport, the business environment, the judicial system, services and healthcare. The approach to structural reforms is heavily frontloaded. Already in 2011, Portugal is expected to implement a first batch of measures aimed at strengthening labour market functioning by limiting severance payments and making working time arrangements more flexible. Unemployment benefits will be reformed with a view to avoiding unemployment traps and increasing the fairness of the system. In the energy sector, network industries and services, Portugal will adopt measures to promote competition and flexibility. The overarching objective of these structural reforms is to raise potential GDP growth, notably by boosting productivity and labour use. Making rapid progress towards this goal is key for employment and welfare, as well as for long-term fiscal sustainability (CEC, 2011a,c).

The social costs of an economic adjustment of this magnitude have been and will continue to be profound. The main victims are the large thousands of persons losing jobs and those facing accrued difficulties in finding a new one, 619,000 according to the last numbers available (end of 2010) and around 750,000 or even more in the near future (the IMF projects an unemployment rate of 13.4% for 2013, a value never seen before in Portugal). Additionally, the most emblematic measures in this context were a reduction of nominal public wages between 3.5 and 10% for salaries above EUR 1.500 per month, with projected savings of 5% in the overall wage bill and a freezing of all public pensions and wages under EUR 1.500. With a Consumer Price Index (CPI) of 1.4% in 2010, these measures represented a large real income loss for active civil servants (between 4.9 and 11.4%) and a small loss for retirees (Graça João Carlos, et.al., 2011).
The fiscal policy, however, has the most relevant impact on the living conditions of the Portuguese citizens, and deserves a more careful examination. The fiscal adjustment for the period 2011-2013 is violent, particularly in the current year, aiming at a deficit reduction of 3.2% of GDP (from 9.1 to 5.9%), followed by cuts of 1.4% and 1.5%, in order to meet the Stability and Growth Pact requirement of 3% in 2013. On the expenditure side, the public sector employees, active or retired, are again one of the most sacrificed groups. Following the mentioned 5 percent cut in public sector nominal wages included in 2011 budget, wages and pensions will be frozen in nominal terms in 2012 and 2013, and promotions severely constrained. On the revenue side, several measures will impact on the real disposable income of the Portuguese tax payers, namely: the reduction of personal income tax benefits (health, education, rents, and mortgage interest payments for owner-occupied housing, etc.); changes in property taxation, reducing the temporary exemptions for owner-occupied dwellings and updating the notional property value of real estate assets; raise VAT revenues, not by changing the rates but by reducing exemptions and moving categories of goods and services from the reduced (6%) and intermediate (13%) VAT tax rates to higher ones (a very sensitive measure, for the more vulnerable groups of society); increase excise taxes (car sales, tobacco products and electricity, this last as yet not subjected to excise taxation) (Graça João Carlos, et.al., 2011).

One of the most controversial measures of the program is the so called fiscal devaluation (a major reduction in labor costs, by means of the employers’ contribution to the Social Security system – *taxa social única*, currently at 23.75% – fiscally neutral, that is to say, compensated by other taxes or expenditure reductions. The competitiveness impact of this measure is small (at least for the value of 4% that was mentioned, around EUR 1.6 billion) and the risk for the sustainability of Social Security is high. Other measures include the unprecedented cut in public investment and reevaluation of all major PPP projects, the most emblematic being the high speed train connection Lisboa-Madrid and the acceleration of the privatization programme of public companies (airline, the freight branch of railways, petrol, electricity, post, and the insurance sector of CGD) (Graça João Carlos, et.al., 2011).

Finally, it needs to be stressed that in contract with Greece, and despite the reactions, the Portuguese voters conceded 78% of their votes to the parties that signed the agreement. Additionally, the Memorandum of Economic and Financial Policies and the corresponding Technical Memorandum of Understanding signed by the representatives of the *troika* and the center-left government of the socialist party (Partido Socialista) with the support of the main opposition parties (Partido Social Democrata and Centro Democrático Social) of the right political spectrum, that a few days later would come to win the general elections and will in fact implement the programme in coalition.

In sum, variation in macroeconomic/structural policy between Greece and Portugal involves the persistent gap in economic performance over the last 20-25 years substantiated with several macroeconomic indicators on the one hand, and in the differences in terms of reaching a political consensus and demonstrating a cooperative culture at large identified with regard to agreeing on the way out/overcoming of the current economic crisis.
Cohesion policy

The key issues surrounding the implementation of cohesion policy over time in terms of adaptation and adjustment are the effective and efficient use of EU funds, the actual policy outcomes in achieving competitiveness and socio-economic cohesion, and policy innovation in the way in which policy is implemented. In that respect, with regard to the former, there seems to be a differentiation between Greece and Portugal and other cohesion countries in relation to the effect of EU structural policy interventions. In particular, structural policy interventions in the post-1994 period are much more physical infrastructure-oriented in Greece than primarily in Portugal and Ireland, where more emphasis is placed on the development of human capital rather than on physical infrastructure (see table 1). Indeed, since the mid-1990s, the development of infrastructure came to be viewed as the first step of the Europeanization of Greece and, simultaneously, as a prerequisite for the success of the modernisation process in other sectors of public policy. Thus, unlike other policy areas, where the outcomes of the Europeanization and modernisation processes may be seen as ambiguous 4, the development of physical infrastructure as a priority of the overall development policy since the mid-1990s came to be regarded as a success story for Greece. This trend, however, was underpinned by arguments about the generally bad condition of almost any sector of the country’s physical infrastructure, as well as, by reference to what other comparable countries, notably Portugal and Ireland, had already done or were doing. In fact, there was a widespread feeling that the funds of the IMPs and the first CSF, having been dispersed on the several small-scale, regional projects across the country, had much less impact than they would have had if they concentrated on large-scale infrastructure projects (see Paraskevopoulos, 2005).

Yet, this has had serious implications for policy outcomes in terms of improving competitiveness and achieving socio-economic cohesion. In particular, Portugal has substantially improved its competitiveness rate and therefore it is in a much better position than Greece in the relevant index, primarily through increased human capital and R&D spending (CEC, 2010a:69). On the other hand, it is much more effective and efficient than Greece in social policy, i.e. it has a much better performance than Greece in population at risk of poverty after social transfers (CEC, 2010a:106).

With regard to policy innovation in the implementation phase, although Greece has arguably been experimenting with crucial reforms in terms of decentralization and devolution, such as the so called “Kapodistrias” and “Kalikratis” plans, both countries are facing almost the same issues with regard to policy formulation and implementation during the current programming period (2007-2013), though the success stories for Greece are almost exclusively identified with improvement in physical infrastructure. Thus, according to the responses of institutional actors at

4 Such areas may include primarily regulation in public policy in general and especially in financial services and/or mass media, environmental policy, education, or areas of social policy. See in particular Featherstone and Kazamias (2001); Paraskevopoulos, (2005).
the national and regional levels, entrepreneurship and competitiveness through innovation and sustainability, as well as fostering social inclusion through employment and non-discrimination are the main issues dominating cohesion policy in the current programming period, that is in formulating the NSRFs. Yet, in the Greek case, the emphasis on sustainability and competitiveness, not least as part of the Gothenburg Strategy, following the Community Strategic Guidelines on Cohesion and taking into account Greece’s weakness in relation to specific indicators of the Lisbon agenda, such as those of the “knowledge economy”, the main features of the NSRF for Greece are reflected primarily on the reorientation of policy priorities in the Sectoral Operational Programmes (SOPs). Conversely, at the regional level, the top-down structure of cohesion policy interventions in the current programming period, along with creeping centralization in policy implementation are identified as the main issues dominating policy. Additionally, given the delays in the implementation of policy, especially in Greece (programmes’ absorption rates vary between 15-20% maximum), it has been difficult to identify clear-cut successes/success stories and/or failures. However, the shift in focus from infrastructure to ERDF actions in favour of entrepreneurship and competitiveness is identified as a success in Greece. In that respect, institutional respondents have emphasized policy/programme implementation rather than policy design/formulation as possible explanatory variable for success or failure. Thus they underlined the importance of improved levels of coordination among actors participating in the implementation of policy/programmes. In the same vein, they have emphasized important institutional weaknesses at the level of central administration, particularly in Greece, vis-a-vis increased EU programme requirements with regard to institutional, that is administrative capacity at the domestic level of governance.

With regard to the impact of and response to the economic crisis, there have been efforts, particularly in Greece, towards acceleration of pace in policy/NSRF implementation at both the national and regional levels. This has resulted in increased emphasis on the management of the funds with subsequent pressures with regard to the level of absorption in almost all policy areas/programmes.

Overall, in Greece there seems to be a positive view about cohesion policy interventions related to infrastructure improvement measures and the improvement of the quality of ICT networks. Conversely, there is a negative assessment of efficiency of policy interventions focusing on family support and connecting R&D activities of the research community and private firms. Additionally, there seems to be a negative view about the efficiency of cohesion policy interventions in crucial areas of social policy, such as job placement of women and young people, job placement of displaced workers and the elderly and handicapped, and the improvement of female entrepreneurship, in Greece.

In sum, variation in cohesion policy implementation between Greece and Portugal involves primarily the existing gap in effectiveness and efficiency in the use of EU funds with Portugal.

---

5 These are early findings of interviews which were part of fieldwork research conducted in the framework for a DR-Regio research project “The impact of Single Market on Cohesion”, which is currently under completion.
6 It should be noted that Greece lags far behind in relation to most of Lisbon targets, such as job creation and employment rate, particularly for women and older workers, risk-of-poverty rate after social transfers, long-term unemployment rate, greenhouse gas emissions and energy intensity of the economy. Yet, the most striking discrepancy, closely linked to the main goal of achieving a “knowledge economy” is the case of gross domestic expenditure on R&D, whose current level is 0.57% of GDP in 2006 with the EU27 rate at 1.84% and the EU target for 2010 at 3%. It is just indicative for Greece’s position that the R&D expenditure target of 1.5% of GDP has been postponed from 2010 to 2015 (see Paraskevopoulos, 2008).
having achieved considerable gains in manufacturing productivity, and hence competitiveness, through a strong increase in its capital stocks of infrastructure, human resources and particularly R&D and Greece still emphasizing investment in physical infrastructure (see CEC, 2009). Additionally, Portugal seems to be much more efficient in the use of ESF funds in crucial areas of social policy, such as tackling risk of poverty.

**Accounting for variation**

There is a bourgeoning literature on the post-authoritarian transition of and democratic consolidation in the SEU countries. This literature focuses on accounting for the differentiation in the transition and/or democratic consolidation processes among SEU countries in general, but it concentrates more or less on the transition of the so called third wave countries, notably Greece, Portugal and Spain. It draws primarily if not exclusively on the new institutionalist approaches to regime and/or policy change and points to either path dependency and/or actor-based interpretations of variation in post-authoritarian transition. Thus the variables employed for accounting for variation range from historical characteristics in the evolution and typology of dictatorial regimes, cultural aspects (Diamandouros and Gunther, 2001) aspects of the political and/or party systems (Morlino 1998), specificities of the organization of the socio-economic interests (Schmitter 1995), structural variables such as the type of bureaucracy and/or crucial features of the state-society relations, such as different forms of clientelism (Lyrintzis, 1984; Morlino, 1995; Sotiropoulos, 2004). Finally some of these approaches have used more ideational variables, such as the role of ideas in policy-making and policy-change (Pagoulatos, 2004).

This paper, drawing primarily on the institutionalist approaches to Europeanization attempts to complement this literature by shedding more light on the potentially crucial role of qualitative features of the domestic institutional infrastructure, such as impartiality, rule of law, or the so-called quality of government, in conjunction with important social norms, such as social trust and cooperative culture. Moreover, this shift in emphasis goes hand-in-hand with similar trends in the contemporary democratic theory (see inter alia Maravall and Adam Przeworski, 2003; Morlino, 2004). In that respect, the paper concentrates on corruption, inequality and social and/or institutional trust, on the one hand, as well as on the so called “quality of governance” variables”, notably rule of law, bureaucratic effectiveness and government voice and accountability, on the other, as crucial features of the domestic institutional infrastructure closely linked to its learning and adaptation capacity. In other words, these variables may play a crucial role in facilitating or inhibiting the adaptation and adjustment processes of the domestic institutional and policy-making structures by shaping interactions among actors within institutional and/or policy networks, such as advocacy coalitions and/or issue networks, that play a key role in policy change and policy adaptation (see Sabatier & Jenkins-Smith, 1993; Paraskevopoulos, 2001). It is in that respect that these variables constitute intrinsic elements of the concept of administrative capacity as it is operationalized by this paper.

---

7 The term “quality of government” has been introduced by prof. Bo Rothstein and draws on/derives from the so called institutional theory of trust. In a recent study for the EU Commission he and his team have employed the concept/variable as a composite index composed of other variables, namely corruption, rule of law, bureaucratic effectiveness and government voice and accountability (see CEC, 2010c).
Greece, the typical laggard: corruption, institutional weakness & low social trust

Thus Greece may be characterized as a typical laggard in terms of institutional and administrative capacity, demonstrating very high levels of corruption and very low social trust. Additionally, its performance in the rule of law, government effectiveness and voice and accountability measurements of the QoG index is well below EU average. Hence, from macro-analytical perspective, Greece’s position vis-à-vis the other EU member states is depicted within a group of primarily Balkan and/or Eastern European countries with a few exceptions of Southern Europe, demonstrating very low levels of social capital and capacities for collective action (see figs 7-14; Paraskevopoulos, 2011). This is further vindicated by the cluster analysis of the QoG study, which reveals that Greece belongs to the so called group 3 of low performing countries, along with the Czech Republic, Lithuania, Hungary, Slovakia, Poland, Latvia, Italy, Bulgaria and Romania (see CEC, 2010c). In that respect, the extremely low level of social trust and social capital endowments, in terms of both interpersonal trust and trust in public institutions, has serious implications for Greece’s low levels of cooperative culture which seems to be a dominant feature of Greece’s institutional infrastructure. These features of the domestic institutional infrastructure seem to be linked with statism—that is the centralized and simultaneously weak administrative structure— and subsequently constitute a serious impediment to the processes of institution building, policy learning, adaptation and substantial reform of the public policy structures in general and in the areas of macroeconomic adjustment and cohesion policy in particular.

Yet, interestingly enough, Greece demonstrates rather moderate levels of economic inequality (see fig. 9). This finding is particularly interesting given that it seems to vindicate the so called institutionalist theory of trust, which emphasizes the role of institutions and not inequality as the crucial independent variable affecting the level of social trust within the framework of the vicious cycle between the three sticky phenomena/variables (i.e. corruption, inequality and trust) (see Rothstein, 2005; Uslaner, 2008; Paraskevopoulos, 2011).

[Fig 7-14 about here]

Portugal, the outsider: institutional performance (quality of government - QoG) with high inequality and low social trust

Portugal, on the other hand, constitutes an outsider, demonstrating medium to low levels of corruption, but simultaneously low social trust and very high inequality. Additionally, its performance in the rule of law, government effectiveness and voice and accountability measurements of the QoG index is very close to EU average. Hence, from macro-analytical perspective, Portugal’s position vis-à-vis the other EU member states is depicted within a group of moderate West European countries with a few exceptions of Eastern Europe (see figs 7-14).

8 That is why Greece has been referred to as a country of ‘free riders in wonderland’ (see Tsoukalas, 1995).
This is also vindicated by the cluster analysis of the QoG study, which puts Portugal in the group 2 of moderate, medium-performing countries, along with France, Spain, Belgium, Malta, Cyprus, Estonia and Slovenia (see CEC, 2010c). These features of Portugal’s institutional infrastructure, and especially the comparatively better institutional performance, can account for the comparatively better administrative capacity and better quality of government, and for the –even marginally- better policy outcomes than Greece. Yet, Portugal, as an outsider does not vindicate either the institutionalist theory or the inequality theories of trust.

**Conclusion**

This paper discusses the impact of Europeanization on domestic governance and policy-making structures and examines the possible variation in the evolution of the adaptation and adjustment processes to the pressures of Europeanization in two comparable SEU countries, Greece and Portugal, based on evidence from macroeconomic adjustment and cohesion policies. The research hypothesis is based on the assumption that administrative capacity or the quality of government is the most crucial variable affecting the learning capacity and therefore the adaptation and adjustment processes of the domestic level of governance.

Variation in macroeconomic/structural policy between Greece and Portugal involves the persistent gap in economic performance over the last 20-25 years substantiated with several macroeconomic indicators, on the one hand, and in the differences in terms of reaching a political consensus and demonstrating elements of cooperative culture at large, identified with regard to agreeing on the way out/overcoming of the current economic crisis.

Variation in cohesion policy implementation between Greece and Portugal has been identified primarily with the existing gap in effectiveness and efficiency in the use of EU funds, with Portugal having achieved considerable gains in manufacturing productivity, and hence competitiveness, through a strong increase in its capital stocks of infrastructure, human resources and particularly R&D and Greece still emphasizing investment in physical infrastructure. Additionally, Portugal seems to be much more efficient in the use of ESF funds in crucial areas of social policy, such as tackling the risk of poverty.

This variation is attributed to the levels of administrative capacity and quality of government in the two countries. Thus Greece is characterized as a typical laggard in terms of institutional and administrative capacity, demonstrating very high levels of corruption and very low social trust, while its performance in the rule of law, government effectiveness and voice and accountability measurements of the QoG index is well below EU average.

Conversely, Portugal constitutes an interesting outsider, demonstrating relatively low levels of corruption, but simultaneously low social trust and very high inequality. In that respect, its performance in the rule of law, government effectiveness and voice and accountability measurements of the QoG index is very close to EU average.
Appendix

Figure 1
The research hypothesis

Quality of (pre-existing) Institutional Infrastructure

Cooperative Culture/Social Norms/Social Capital

Administrative Capacity/Quality of Government

Public Policy Performance/Adjustment
Figure 2

GDP Annual Growth (1992-2012)
Figure 3
Current Account Balance (1992-2012)
Figure 4
Figure 5
Unemployment Rate (1992-2012)
Figure 6
## TABLE 1

EFFECT OF STRUCTURAL POLICY ON PHYSICAL INFRASTRUCTURE AND HUMAN CAPITAL, 1994-2010: HERMIN SIMULATION RESULTS
(% DIFFERENCE FROM BASELINE WITHOUT POLICY IN 2010)

<table>
<thead>
<tr>
<th>Years</th>
<th>Greece</th>
<th>Spain</th>
<th>Ireland</th>
<th>Portugal</th>
<th>East Germany</th>
<th>Northern Ireland</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Physical</td>
<td>Human</td>
<td>Physical</td>
<td>Human</td>
<td>Physical</td>
<td>Human</td>
</tr>
<tr>
<td>1993</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>1994</td>
<td>1.1</td>
<td>1.0</td>
<td>1.2</td>
<td>0.7</td>
<td>1.1</td>
<td>1.5</td>
</tr>
<tr>
<td>1995</td>
<td>2.7</td>
<td>1.9</td>
<td>2.3</td>
<td>1.4</td>
<td>2.3</td>
<td>2.9</td>
</tr>
<tr>
<td>1996</td>
<td>3.9</td>
<td>2.7</td>
<td>3.3</td>
<td>2.0</td>
<td>3.3</td>
<td>4.1</td>
</tr>
<tr>
<td>1997</td>
<td>4.9</td>
<td>3.5</td>
<td>4.3</td>
<td>2.6</td>
<td>4.3</td>
<td>5.5</td>
</tr>
<tr>
<td>1998</td>
<td>6.0</td>
<td>4.1</td>
<td>5.4</td>
<td>3.4</td>
<td>5.1</td>
<td>6.6</td>
</tr>
<tr>
<td>1999</td>
<td>7.0</td>
<td>4.8</td>
<td>6.5</td>
<td>4.0</td>
<td>5.8</td>
<td>7.6</td>
</tr>
<tr>
<td>2010</td>
<td>4.8</td>
<td>2.8</td>
<td>4.6</td>
<td>2.1</td>
<td>2.5</td>
<td>4.1</td>
</tr>
</tbody>
</table>

Figure 7
Corruption and Social Trust (2004)\(^9\)

Corruption Perception (Transparency International 2004)


---

\(^9\) Corruption: (Transparency International-Corruption Perceptions Index, 2004): 10 (corruption free) and 0 (total corruption).
Figure 8
Corruption and Social Trust (2008-09)\(^{10}\)


10 Corruption: (Transparency International-Corruption Perceptions Index, 2009; Social trust: European Social Survey-ESS, 4th wave (2008-09).
Figure 9
Economic Inequality and Social Trust (2000s)\footnote{11}


\footnote{11 OECD-Gini Index of Economic Inequality (mid-2000s); Social trust: European Social Survey-ESS, 4th wave (2008-09).}
Figure 10

Rule of Law in E.U. Member States

Figure 11

Government Effectiveness in EU Member States

Figure 12

Corruption in E.U. Member States

Figure 14

References


CEC (2010c) *Measuring the Quality of Government and Subnational Variation*, Report for the European Commission Directorate-General Regional Policy, the Quality of Government Institute, Department of Political Science, University of Gothenburg, Sweden.


Rothstein, Bo (2005) *Social Traps and the Problem of Trust*, NY: CUP.


