

Greece's Path to the Crisis: The Democratization of Rent-Seeking in Greece

The Political Economy of the European Debt Crisis

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What the Lecture is About

- A brief synopsis of economic history in post-WWII Greece, within a political-economy framework.
- An attempt to explain the evolution of the power struggle among different stakeholders, who tried, via strategic positioning and rent-seeking activities, to influence economic policy outcomes.
- Pre-crisis, post-war era is split in three periods (1953-1973, 1973-1993, 1993-2008) and we identify the important players to see how they manage to forge a sustainable winning coalition, and to understand the efficiency properties of the enacted policies.
- Lecture ends with a discussion of Greece's on-going Great Depression

Methodological Underpinnings

- We try to understand how interest groups attempt to become more effective in exercising their power by guarding against free riding behavior, through the implantation of protective rules.
- Conditions which are external to the analysis, e.g. soft budget constraints due to access to outside financing, are also used to understand different societal tolerance to inefficient public policies.
- Even when external conditions are conducive to inefficient outcomes one has to understand the reasons for which a more efficient outcome does not arise (Coase-Williamson).
- The ideological background within which public discourse on economic policy developed in Greece has been very important.

Antecedents of the post-WWII economic order (1)

A perennial problem of Greek political economy

- *“Before the (1908) revolution, it was those connected with the expenditure column of (those feeding on) the budget that mainly governed Greece. Now, its fortunes are mainly in the hands of those who feed the budget’s revenue column.”* (Venizelos, 1911)
- *“...the bourgeois state must realize that the danger posed by the lower-classes in the twentieth century can be thwarted only by making sure that the just demands of the workers are swiftly met.”* (Venizelos, 1911)

Antecedents of the post-WWII economic order (2)

Eleftherios Venizelos:

- adopted in 1919 six International Labour Conventions, which dealt with hours of work, unemployment, maternity protection, night work for women, minimum age and night work for young persons
- passed a law in 1932 establishing the Social Insurance Foundation (IKA) in 1932; both the Confederation of Greek Industrialists (SEV) and the Banks' Union were against it

However, Venizelos's government was toppled, and IKA was not established until 1937...

Antecedents of the post-WWII economic order (3)

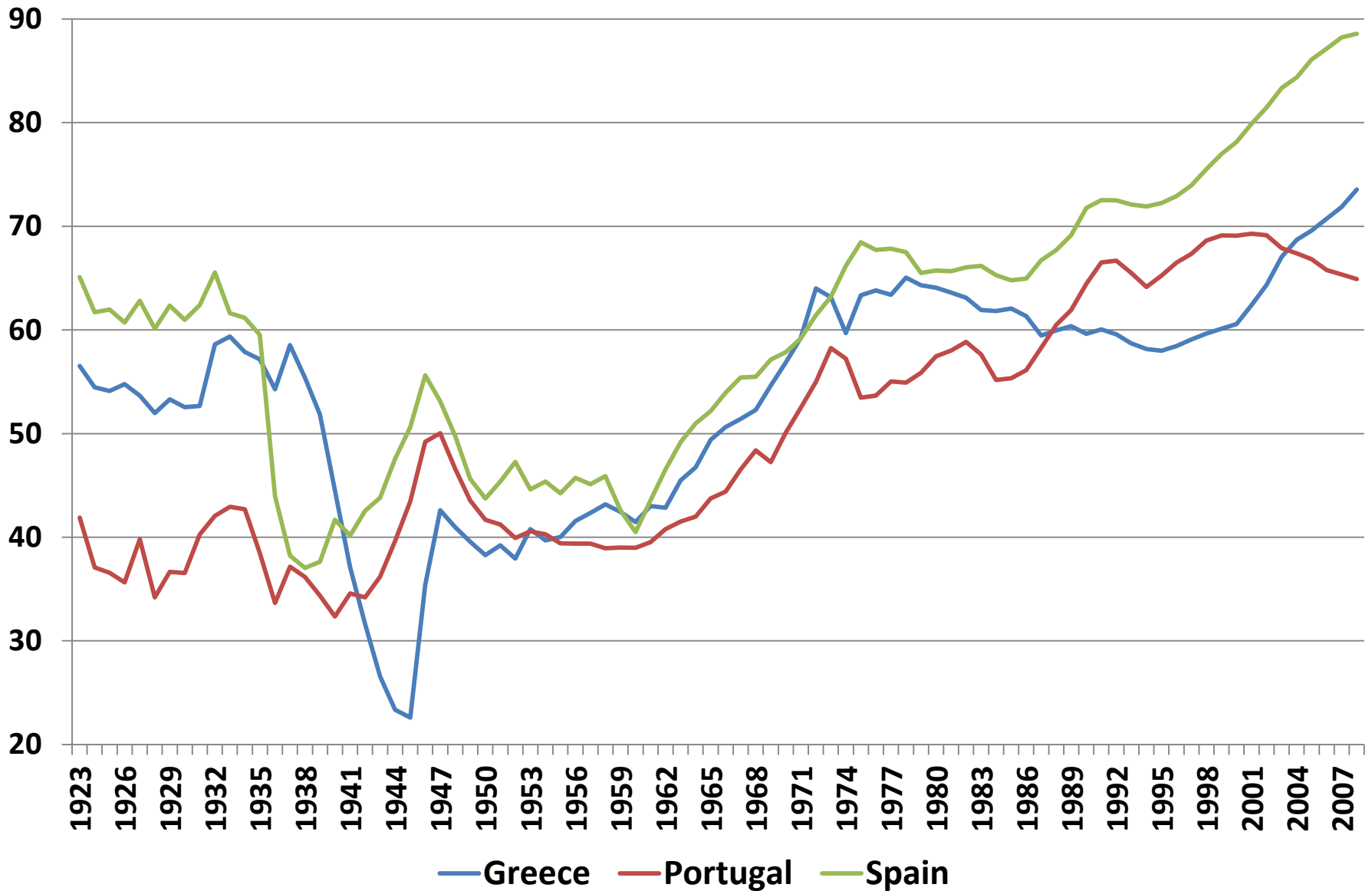
.... during the dictatorship of Ioannis Metaxas (1936-1941)

- the (1932) law was subjected to significant amendments which weakened IKA's scope and curtailed the means available to it
- It coincided with the establishment of many supplementary social insurance funds, whose number kept growing until the dawn of the 21st century.

Metaxas's regime created a system of (corporatist) interest representation in which the constituent units are licensed (if not created) by the state and granted a deliberate representational monopoly in exchange for observing certain "guidelines" on their selection of leaders and articulation of demands.

The goal was to use corporatism as a process for both the repression and co-optation of the labour movement and various interest groups – a system which still survives intact today but under different guises.

GDP per capita relative (%) to 12WE average; Geary-Khamis 1990 dollars



Greece on Life-Support: 1944-1953 (1)

- In 1945, GDP was about 36% of its pre-war level.
- The drop in Greek GDP was larger than that experienced by any other country - including Germany, Japan, and the USSR (Maddison data).
- Hyperinflation had essentially demonetized the economy, and real money balances were, in 1945, only 5% of its pre-war level.
- Popular resentment regarding individuals and firms who collaborated with the Nazis led to a series of legislative initiatives to partially undo such wealth redistribution - yet, many Greeks regarded these laws as grossly inadequate in dealing with collaborators' unethical enrichment
- Widespread belief that a group of collaborators and black-marketers ascended to the ruling class and managed to further gain from their involvement in the Marshall Plan (Kofas, 1989).
- These beliefs, and subsequent political developments, solidified the widespread perception about the unfairness of capitalism in Greece, and solidified the latent demands for extensive regulation and redistribution which surfaced in full force after 1973.

Greece on Life-Support: 1944-1953 (2)

- Access to foreign-aid loans was essentially the only external source of financing for firms.
- Given the complete lack of alternative funding sources and the expectation that these loans would eventually never be repaid in full (as it actually happened in many cases), access to these loans became a coveted prize.
- The main vehicle through which incumbents lobbied was the NBG, which was pressing the Greek government and the US delegation to relegate the management of the loan program to the commercial banks (in reality to NBG itself).
- Almost 43 out of these 50 million USD were given to just ten “large” manufacturing firms (operating in cement, steel, chemical and other heavy industries) creating thus a compact group of “national winners”.

Greece on Life-Support: 1944-1953 (3)

- 100 “Liberty” ships were offered to the Greek government, which were distributed to the old ship-owners, who then managed to acquire 300 more ships reviving the Greek shipping industry. As a result, the ship-owners regained their power and their ability to influence policy.
- Paul R. Porter (Chief of the US Mission to Greece, 1949-50): “... one of our big problems was to get the ship-owners to pay taxes. They were about three years in arrears in taxes... we had to insist that the Government refuse shipping documents to any Greek ship-owner who was in arrears in taxes... considering how dependent so many of the Government officials were on the ship-owners, and also interlocked with them by marriage, family relationships. The amount of taxes that were collected was about 17 million dollars in one week.” This was a large sum: if it represented today the same share of GDP as it was then, it would be about 2 billion euros.

Greece on Life-Support: 1944-1953 (4)

- This period was marked by a brutal civil war.
- The inability of raising tax revenue and the expressed goal towards balancing the budget was precluding the government from instituting any sort of social spending programs .
- As a result the government brought back in full force the corporatist system that was instituted in the pre-war period by the Metaxas regime to protect social cohesion and to avoid leakages of the general population towards the communist insurgents' ranks.
- This created the basis for a coalition involving professionals, self-employed and shopkeepers, whose support for the “liberal” regime (as opposed to communism) hinged on their being granted with privileges at the expense of third parties (e.g., third-party taxes supporting pension funds or government-sponsored collusive price setting).

Catching-Up: 1953- 1973 (1)

- The devaluation of 1953 (drachma lost 50% of its value against the dollar) set the stage for a long period of rapid growth.
- In 1973 GDP per capita in Greece was 3.32 times higher than its level in 1953; the corresponding number for WE12 countries was 2.14, for Portugal 3.07, and for Spain 3.03.
- To a large extent, this, above-average performance of the Greek economy is a normal catching-up episode.
- It also reflects the medium-run successes that often accompany high rates of domestic saving and capital accumulation as the economy shifts from low-productivity sectors (agriculture) to high-productivity ones (manufacturing). During this period, the share of services in GDP remained constant (at 50%), whereas the share of the secondary sector increased from 20% to 35%.

Catching-Up: 1953- 1973 (1)

Why did the share of services stay constant?

Hypothesis 1. This was due to conscious policy exercised by the Currency Committee, which remained an important feature of economic policy until its demise in 1982. The Committee was the pre-eminent manifestation of state autonomy in the sense of rising above the demands of various socioeconomic groups and focusing on a developmental strategy which relied on extensive interventionism in the allocation of credit, aiming to encourage manufacturing and exports, and to restrict consumer and trade finance.

Hypothesis 2. The power of manufacturing-sector interests was particularly strong during this period (relative to the commercial-sector interests and of the “liberal” professions). Also, limited financing opportunities played an equally important role in the propagation of oligopolistic structure in most industries, as they favored incumbents (i.e., “national winners”). Banks were not only playing their traditional lending role but, more often than not, they were also acquiring direct ownership stakes in the incumbents. This created relational vested interests in the banks, which were thinking twice before financing new, possibly competitive, ventures.

Catching-Up: 1953- 1973 (3)

- Protective regulations in many services allowed most self-employed professionals to substantially benefit from rapid growth, and the tacit understanding that tax evasion was “permissible” .
- The corporatist system of guild-like trade unions and professional associations was kept intact. They were given the authority to regulate entry (via permits or licenses), to set prices, to impose penalties on their members, and even to the general public through the imposition of taxation whose revenue were earmarked for the benefit (e.g. pension funds) of their members (thus mitigating internal free-riding problems).
- During the colonel’s junta (1967-74), the Currency Committee was marginalized, and large corporate-welfare handouts were given to many incumbent or regime- affiliated entrepreneurs. The result of this was to solidify the widespread feeling that Greek capitalism was of the crony-variety which characterized most of the middle-income countries of that era (*oligopolized rent-seeking*).

Overt Populism: 1973-1993 (1)

- Democracy was restored in 1974
- PASOK came to power in 1981
- EEC entry in 1981
- Mediocre growth performance: in 1993 GDP per capita in Greece was only 1.30 times higher than its level in 1973, whereas the corresponding numbers for the average of 12WE countries was 1.40, 1.58 for Portugal, and 1.60 for Spain.
- 1993 Greece decided to aim for accession to the EMU.

Overt Populism: 1973-1993 (2)

Why did growth decelerate?

- Most of the deceleration happened after 1980; GDP was 22% higher in 1980 than in 1973, and only 10% higher in 1993 than in 1980.
- The investment to GDP ratio dropped to 20.5% (down by about 9 p.p. relative to the 1960-73 period); almost half of the drop in the investment ratio had happened by 1981.
- Very large rise in minimum wages for private-sector employees in 1981; for (some) public-sector employees the rise was as large as 100%.
- EEC entry a big shock for the overly-protected Greek manufacturing sector.
- Not easy to separate the effect of “PASOK” from EEC entry.

Overt Populism: 1973-1993 (3)

- The dismantling of repressive political mechanisms after 1974 meant that governments had to rely on social and economic policy measures in order to garner political support.
- This led to a transfer of power from the state to “society”, or rather, from a moderately-effective state bureaucracy (the semblance of a strong state in the Weberian tradition) to groups that claimed to better represent society’s interests.
- The conservative (New Democracy) governments of 1974-81 increased spending on social insurance, whose share of GDP rose from 11.3% of GDP in 1974 to 16.4% in 1981.
- Still, a broad segment of the public was demanding a change from the post-civil war socioeconomic regime which, they perceived, had effectively marginalized large segments of the population by conferring undue privileges to a handful of citizens (“the privileged”), and which the 1974-81 conservative governments did little to upset.

Overt Populism: 1973-1993 (4)

- Sensing the public's desire for an end to “a long-lasting post-civil-war regime”, PASOK managed to express, represent and legitimize a heterogeneous range of collective demands that were excluded from the political arena.
- These demands often failed to satisfy broadly desired social objectives. A particularly poignant example concerns PASOK's intention to create “decentralized organs of social control”, which was essentially a euphemism for its attempt to transfer control over semi-public and even private sector firms to union members affiliated with the party.
- This was accomplished via the “socialization” of public enterprises, with authority passing to councils consisting of representatives of management, workers, local authorities, and the state.
- In addition, several large private sector firms got nationalized via the creation of a new state holding company, whose objective, supposedly, was to restructure these so-called “ailing” firms, some of which were heavily leveraged, and deemed insolvent.

Overt Populism: 1973-1993 (5)

- All these efforts failed to achieve their stated objectives of “social control”, but were immensely successful in assigning to party affiliated union members the real power of redistributing resources. As a result, they were used for furthering PASOK’s electoral aspirations, and for “*democratizing*” rent-seeking opportunities.
- The democratization or proliferation of rent-seeking was the main by-product of the infiltration of every aspect of economic and social life.
- It was achieved by replacing the old patron-client relationships in which relatively few policymakers and administrators were able to dispense favours to a select few, to a system in which the power was dispersed by allowing a large number of lower-ranked, but party-affiliated, bureaucrats and trade unionists to, effectively, exercise veto power in practically all decisions which required the involvement of any state or quasi-state agency.

Overt Populism: 1973-1993 (6)

- These developments, along with the decreasing profitability and influence of industrial capital, incentivized existing or aspiring entrepreneurs to form alliances with party functionaries, and to concentrate their activities in sectors in which subsidies and public procurement were relatively plentiful.
- The rent-seeking aspects of clientelistic politics were further enhanced by the gradual weakening of the “authoritarian” civil-service code, which opened the way for widespread anomie among civil servants, who realized that affiliation with the party in power increased both their chances of promotion and, effectively, guaranteed non-punishment for unlawful conduct.
- The attraction of PASOK to existing and aspiring public-sector employees was enormous: as the number of public-sector employees nearly increased from about 500,000 in 1980 to over 900,000 in 1989, the vast majority of new appointments were PASOK supporters.
- PASOK more than tripled its membership from 1981 to 1986, and 89% of its members who joined the party since 1981 were public-sector employees.

Overt Populism: 1973-1993 (7)

- PASOK's policy is more aptly understood as populist, given the absence of a significant cleavage in Greek politics along class lines. This has been due to the relatively small industrial base and small number of industrial workers.
- Already in the 1980s, public-sector employees and the self-employed (about half of which were in agriculture) were making a social majority (Tsoucalas, 1987).
- Studies of voting behavior in Greece (Gunther and Moreno, 2001) suggest that indicators of economic/social class are much weaker as predictors of the vote in Greece along the Left/Right axis than in other West European countries - not surprising since, in Greece, class structure is less polarized and wealth inequality is small compared to other European countries.

Overt Populism: 1973-1993 (8)

- These features of Greek society meant that PASOK – in the 1980s – could count on broad political support provided that it availed to large segments of Greek society specific “public goods”.
- These were: employment in the wider public sector at relatively high wages; a lax enforcement of tax law for the self-employed; and the granting of (mostly) unfunded pension rights to various groups – these included the provision of public pensions to persons without prior contributions, and the provision of excessively large pension benefits to selected groups of public-sector employees (including, especially, to those employed in state-owned enterprises and banks) and to the self-employed.
- EU funds allowed the governments since the mid-1980s to secure media support through selective channeling of funds to friendly media barons – who often enough happened also to be winners of lucrative public procurement contracts.

Overt Populism: 1973-1993 (9)

- PASOK's dismal economic performance in the 1980s did not produce a large dent into its popularity among the voters.
- Rise in unemployment (1981:2.7%, 1988:8%) increased PASOK's ability to act as a patron to broad segments of the population, since it became particularly adept in the skillful manipulation of scarcity .
- PASOK's cadres realized that patron-client relationships need not depend on a continuous stream of publicly provided benefits but on sustaining the expectation of rewards in the maximum number of would-be voters for the party with the minimum payoff in concrete benefits.
- Some of these were: the lucrative employment opportunities in state-owned enterprises; preferential access to scarce public goods and services, which, although in principle were accessible to all citizens, their (timely) availability depended on being able to draw on the goodwill of the party's cadres, or on family relatives who happened to be public-sector employees at crucial posts.

Overt Populism: 1973-1993 (10)

- In distinction with the “stationary bandit(s)” regime of the first postwar decades which had a stake in growth as long as it afforded its members a portion of the increased output without jeopardizing the survival of the regime, the post-1981 regime could be interpreted as a “roving bandit(s)” regime, in which, literally, tens of thousands of civil servants and private agents could overtly engage in rent-seeking activities (and covertly in unlikely-to-be-punished outright corruption) without, rationally for each player, too much regard for the detrimental growth effects of such behavior.
- A “growth-without-too-much-trickle-down” regime was replaced by a growth-retarding, “plough-into-the-public-coffers” regime.
- “Ideological bias” influenced public’s attitudes towards specific policies. Di Tella and MacCulloch (2009) provide evidence that citizens’ perceptions about corruption reduce their willingness to support “free-markets” policies and induce them to demand more regulation.

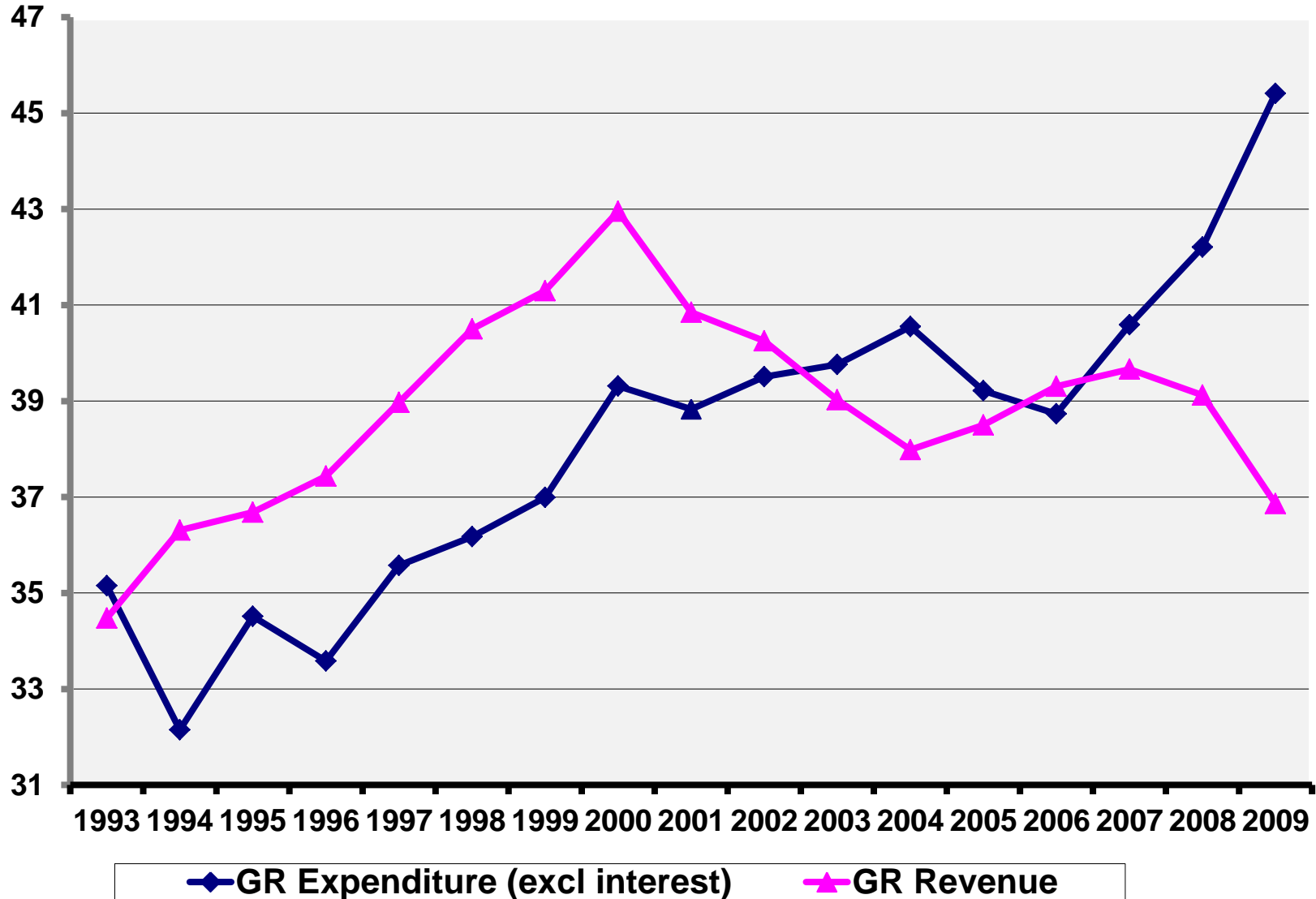
Stealth (Covert) Populism: 1993-2008 (1)

- ND returned to power (1990-93) after a series of high-profile corruption cases brought against senior PASOK officials, and in the wake of three consecutive elections, Mitsotakis eventually received enough support to form a government with a very weak parliamentary majority. This compromised seriously the government's ability to carry out its avowed aim of economic liberalization.
- PASOK returns to power in 1993; its return can only partly be explained by the lackluster economic performance of Mitsotakis's government – PASOK's past performance was equally unimpressive.
- It may be explained by the widespread perception that, despite its manifest shortcomings, PASOK represented the only alternative if the country was to consolidate the wealth and power redistribution achievements of the last two decades, and to put a brake on the return of the "unfair capitalism" of the postwar decades.
- The large decline in income inequality (since 1974), and especially the rise in the income shares of the middle of the distribution meant that the mediocre growth record of the 1980s was not incompatible with increases in the living standards of the "median voter".

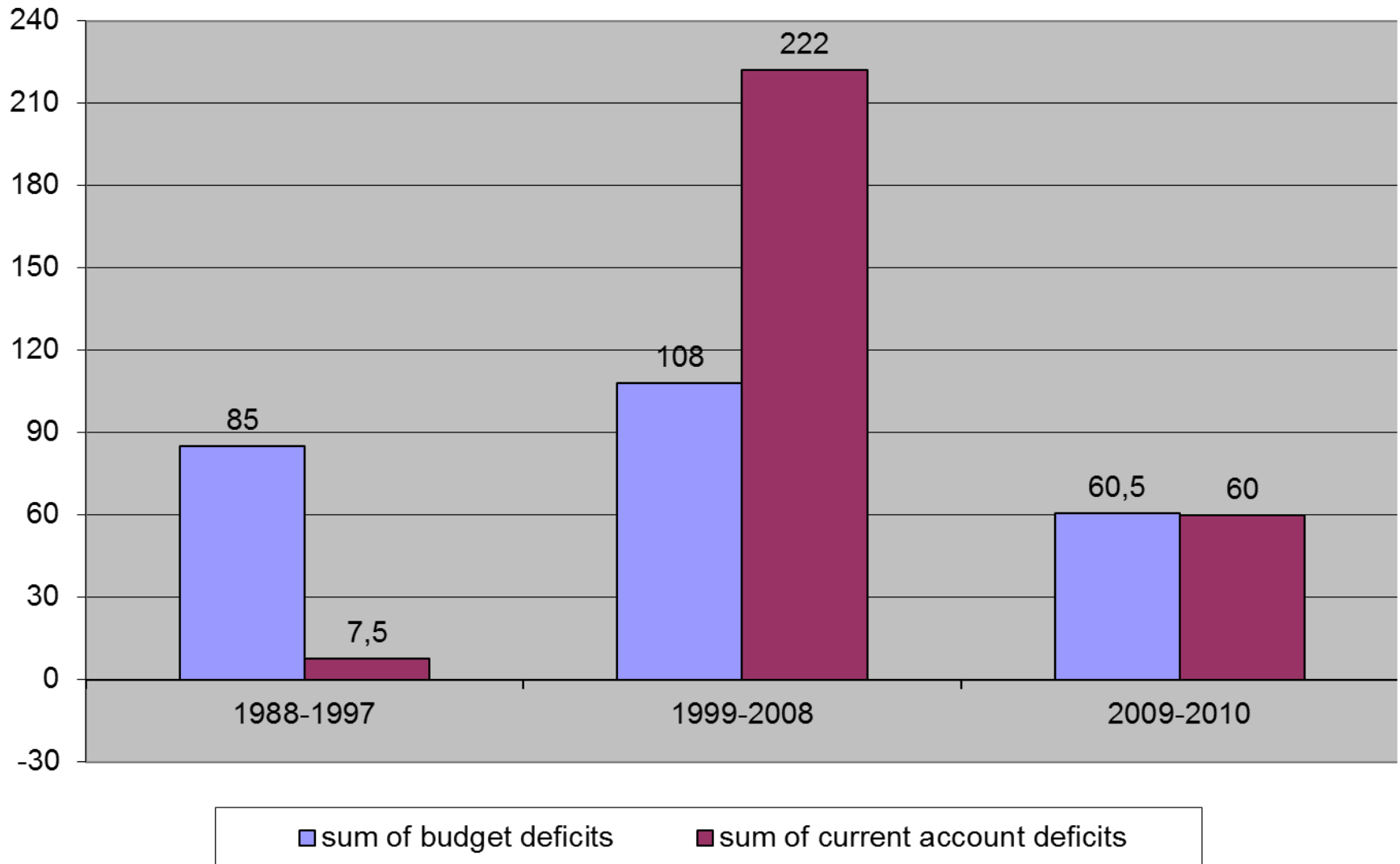
Stealth Populism: 1993-2008 (2)

- Greek economy *appears* to perform better as in 2008 Greek GDP per capita was 1.65 times larger than its 1993 level (for the 12WE was 1.31, 1.29 for Portugal, and 1.61 for Spain).
- PASOK was gradually shedding some aspects of its “third-world populism”.
- Given the publicly stated objective to aim for participation in the EMU, and under pressure from its "modernizing wing" – which eventually ruled the country from 1996 to 2004, PASOK altered its agenda and adopted privatization and liberalization policies.
- At the same time, it appeared to manage to tame budget deficits and inflation, and Greece acceded to the Eurozone on January 1, 2001.

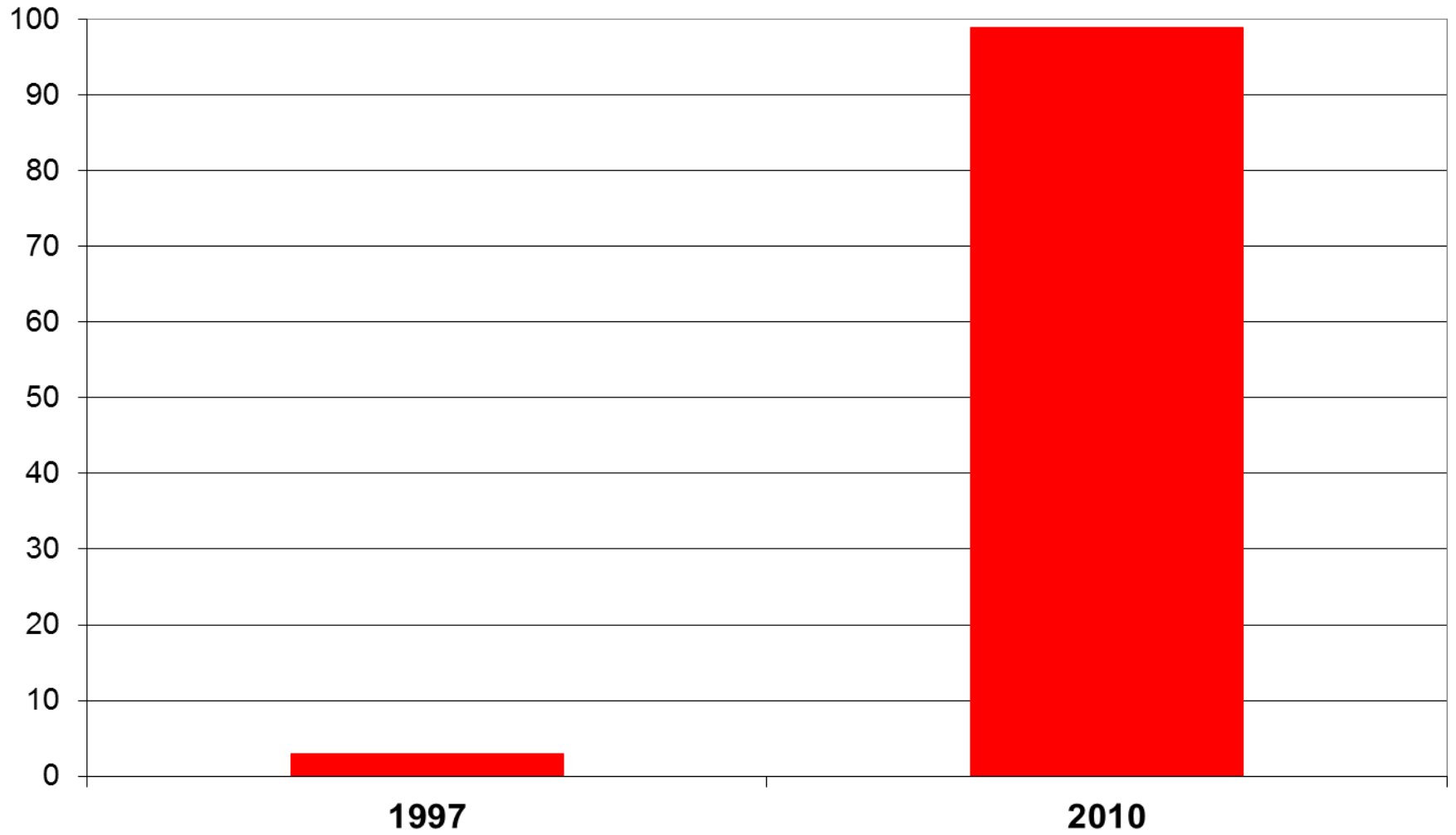
Primary Govern. Spending and Tax Revenue (% GDP)



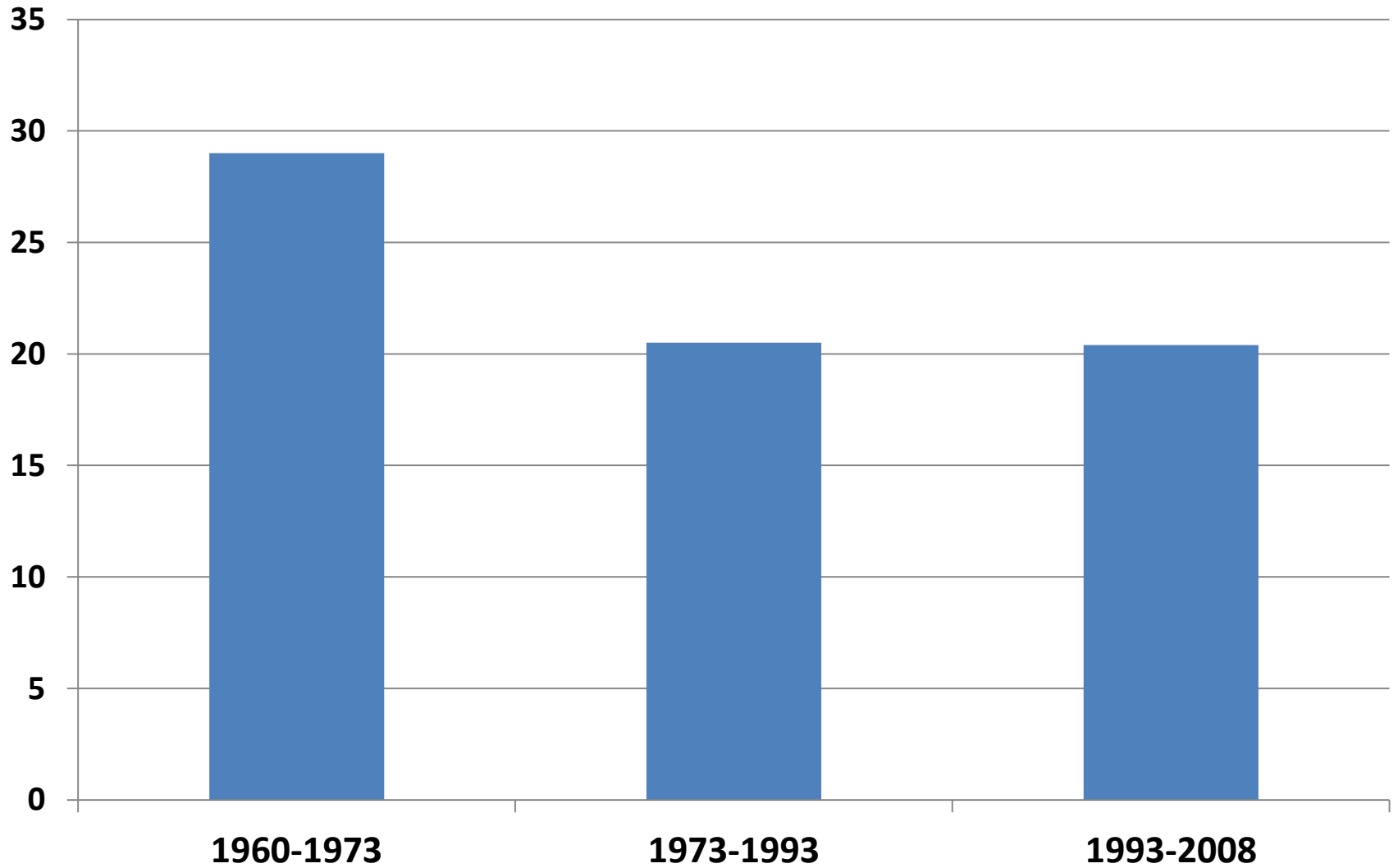
Greece: cumulative budget and current account deficits, bn euros



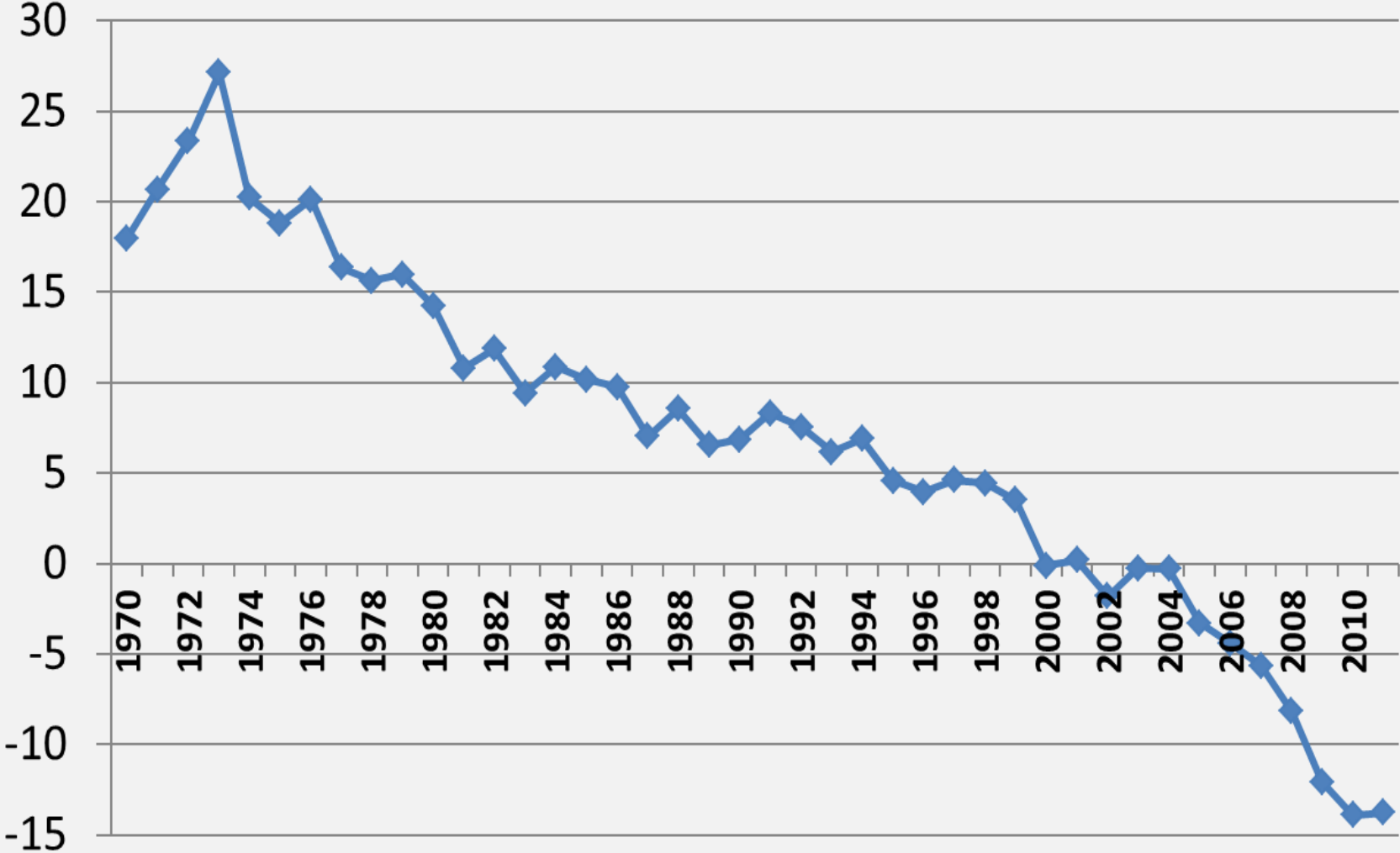
Net Foreign Debt , % GDP



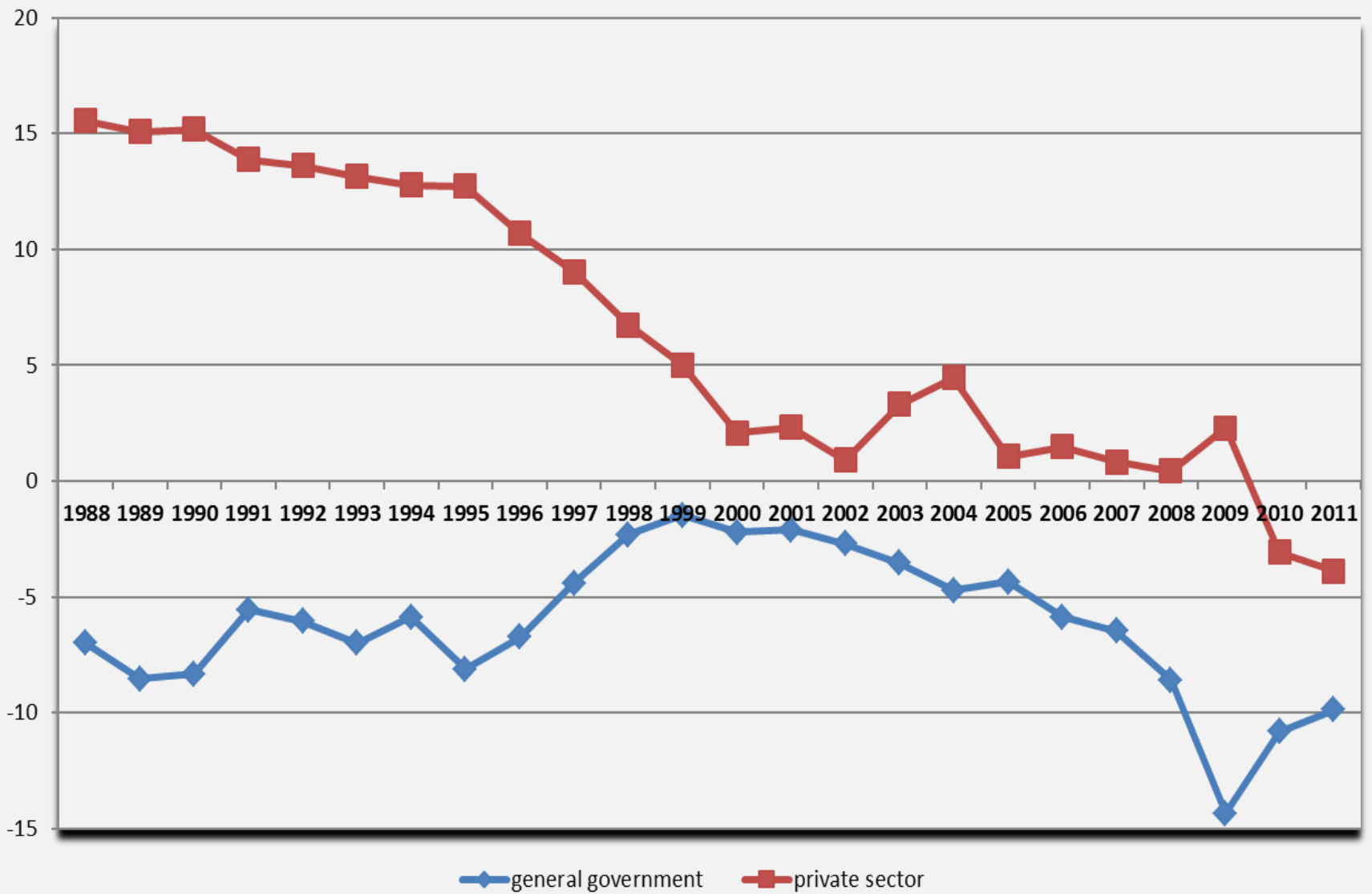
Greece: Investment to GDP ratios (%)



net national saving rate, % GDP



Greece: components of net saving, % of GDP



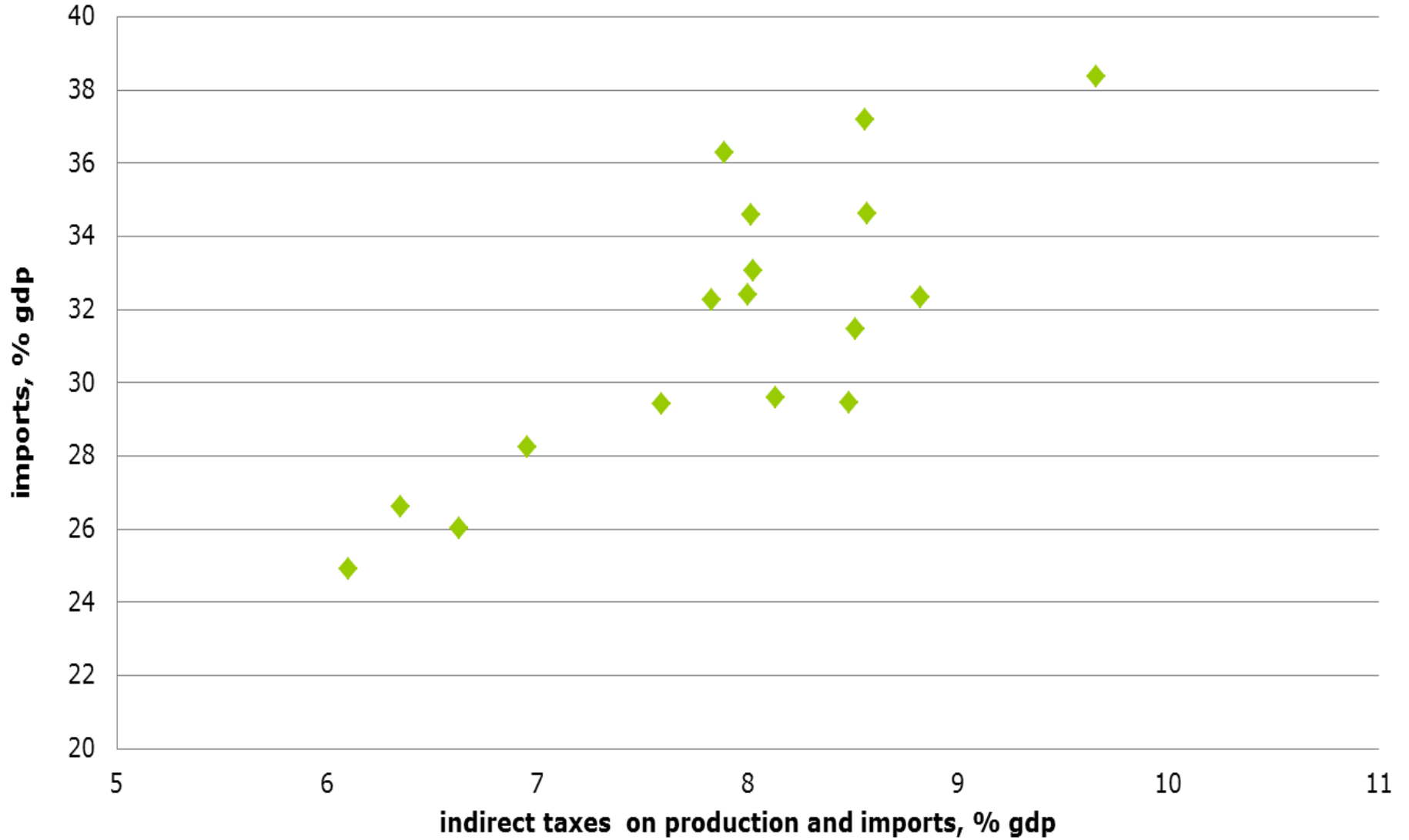
Stealth Populism: 1993-2008 (2)

Why didn't reduced budget deficits lead to lower current account deficits (twin deficits hypothesis)?

- Causality was running in the opposite direction
- Financial liberalization (in full force after 1994) allowed households to borrow excessively from abroad (with the helping hand of domestic banks) and to spend on imported items which allowed the government to collect a lot of tax revenue.
- For example, car imports generate immediate tax revenue (VAT, luxury taxes, etc.). They also allow for increases in domestic value added (e.g., services related to sales, advertising, and repairs of automobiles), thus allowing for second-round increases in income tax revenue.

GOVERNMENTS CONTAINED THE RISE OF PUBLIC DEBT BY MORTGAGING THE COUNTRY TO THE REST OF THE WORLD

import share and indirect taxes



Stealth Populism: 1993-2008 (3)

- Low cost access to foreign borrowing, only part of the story.
- EMU liberalization and privatization agenda was incompatible with the continuation of catering to party cadres needs via the expansion of an already bloated public sector.
- Result was to outsource the redistribution-of- resources facility.
- Rents redistribution facilitator role was taken by many private “entrepreneurs”, who were interrelated with the party machine.
- These entrepreneurs became the beneficiaries of lucrative public procurement contracts, and led to widespread graft as it created an “industry” whose role was to facilitate “information exchange” and “matching” between government functionaries and private actors.
- A side-effect of taking the redistribution of resources “private” was probably an increase in the inefficiency of the process, due to extra effort needed to hide (or legalize) these arrangements.

Greece's Great Depression (1)

- Global Financial Crisis of 2007/08 took the Greek growth-on-(foreign) credit-steroids regime apart with a small delay.
- Once foreign credit to the overextended Greek banking sector collapsed, it took about a year before the “benefits” of huge current account deficits for the government budget deficit to evaporate.
- For the first time after many years, in 2009 the government budget deficit was larger than the current account deficit. i.e., the collapse of foreign lending to the Greek private sector forced, through the channel explained earlier, a large rise in the government budget deficit.

Greece's Great Depression (2)

- Greek government faced a *mission-impossible*
- On the one hand, to make public debt sustainable, the economy should grow so as to increase tax revenue
- On the other hand, to make net foreign debt sustainable, the economy should contract so as to eliminate the huge current account deficit.
- Under these conditions, foreign creditors started demanding interest rates that embodied a high probability of default, thus forcing the government to resort to the official bailout mechanism to avoid the impending (disorderly) default.

The “Bailout”

- EU officials reacted with shock and opprobrium when the new Greek government announced in October 2009 that the projected budget deficit for 2009 was 12.7% of GDP (rather than the 5.1 % projection appearing in the 2009 Spring Commission forecast).
- This announcement was met with shock and opprobrium in Brussels and euro area capitals.
- The opprobrium may well be what Greece deserved.
- The “shock” (especially expressed by EU officials) was not due to the economic significance of the situation but rather to the fact that the Greek government had lied to its euro area partners.
- The EU officials’ reaction like Captain Renault in the film Casablanca. Captain Renault is admonishing Rick (the owner of the café) with the words “ I’m shocked, shocked to find that gambling is going on in here” at the same time as a croupier hands Renault a pile of money with the words “Your winnings, sir”, which he readily accepts.

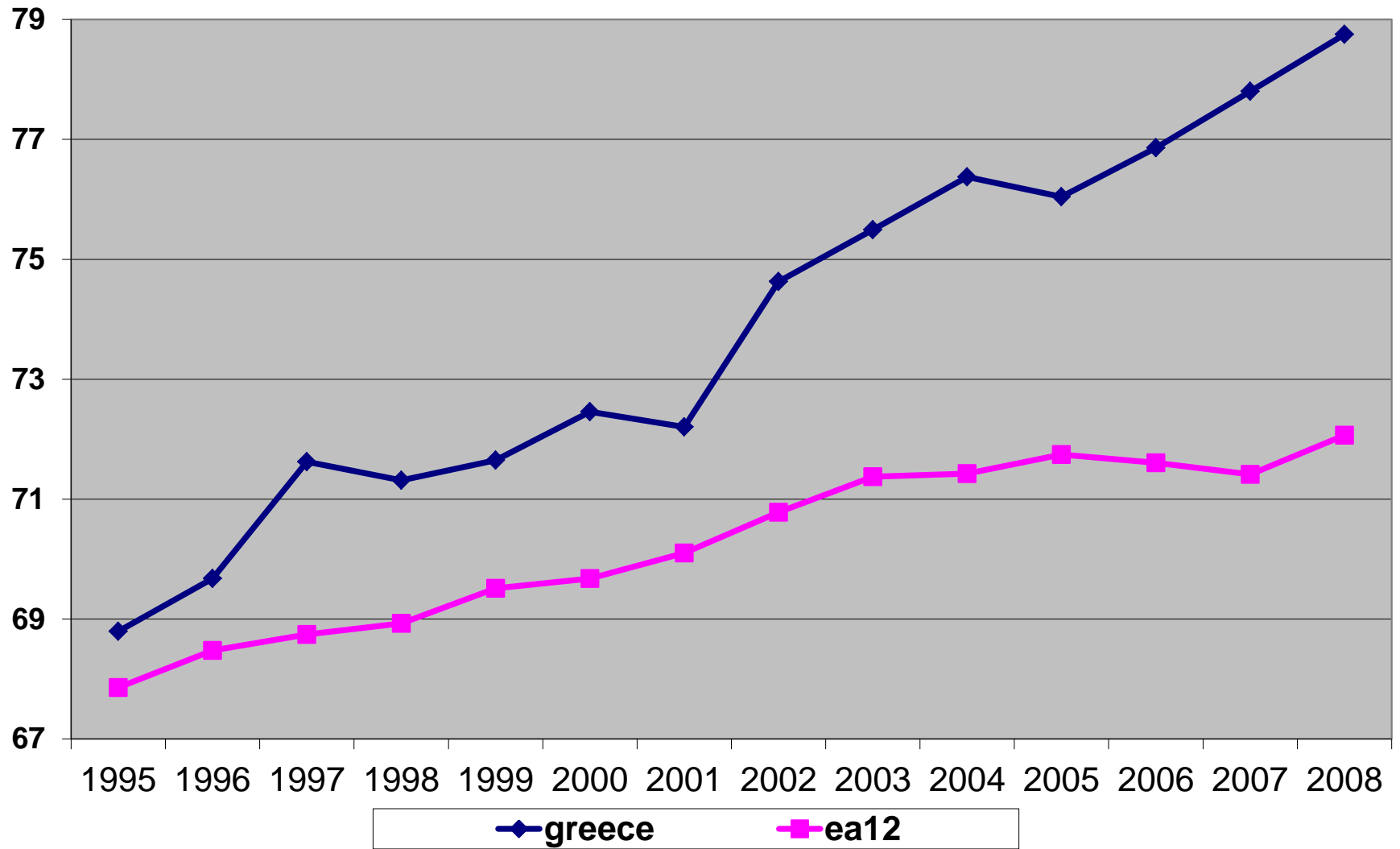
The Bailout / The Greek Government

- The Greek government in 2009/2010 avoided “bargaining” with the Troika
- It did what all Greek governments of the last 30 years did, i.e.

it took the loans

- While it hoped that it would not have to stick to the agreed plan...
- Or, to work –out a credible “alternative” solution
- Despite knowing (?) that the recession would be far greater than “*predicted*” by the Troika

share of services in total GVA, % of GDP



Argentina and Greece, GDP, 1995=100

