

The political economy of the Greek crisis (2010-)

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**POLICY
ANALYSIS
RESEARCH
UNIT**

ATHENS
UNIVERSITY
OF ECONOMICS
AND BUSINESS



structure of presentation

- ❑ context
- ❑ facts
- ❑ interactions
- ❑ key issues
- ❑ conclusions

context

facts

interactions

key issues

conclusions

my topic

- ❖ Greece entered into a bailout agreement with the EU, the ECB and the IMF (May 2010), in return for massive spending cuts and tax hikes, and a programme of structural reforms.
- ❖ *So did Ireland (December 2010) and Portugal (May 2011). The other two GIIPS, Spain and Italy, were subject to softer forms of conditionality.*
- ❖ The bailout agreement has (so far) enabled Greece to remain part of the Euro area - at the cost of a severe recession, widespread misery, and political instability.
- ❖ *The effects of austerity and the crisis (economic, social and political) were also adverse in Ireland and Portugal, but at a significantly lower scale.*
- ❖ Both Ireland (December 2013) and Portugal (June 2014) have now exited their 'Programme'. But Greece's attempts at an early exit (October 2014) and renegotiation (February-July 2015) have backfired.

my research

- ❖ My research aims to look for answers to the obvious question ‘why’ (i.e. why the economic, social, and political effects of the crisis have been so much more severe in Greece than elsewhere).
- ❖ It builds on earlier work on various aspects of the Greek crisis (effects on poverty and inequality, the role of social protection, labour market segmentation, tax evasion, pension reform), including the political fallout (the rise of populism and extremism, and political violence).
- ❖ It extends previous research by adopting a comparative perspective: primarily with Ireland and Portugal, but also with Spain and Italy.
- ❖ It runs in parallel with other research on minimum wage legislation, unemployment and poverty (in Greece, Germany and the US), pension reform (in Southern Europe), and social safety nets (in Southern and Eastern Europe).

my views

- ❖ I cannot claim to be a detached observer: I have been an active participant to the public debate on what's wrong with Greece
- ❖ In a nutshell, my views can be summarized as follows:
 - With a budget deficit at 15.6% of GDP (in 2009) and a current account deficit at 14.9% of GDP (in 2008), the 2010 bailout agreement was not the cause of Greece's troubles, but their inevitable effect.
 - The country's growth model is no longer sustainable, and remains indefensible on economic, social and political grounds.
 - The Left and unions should not have rejected austerity outright, but strive to make it equitable and consensual. Austerity could have been an opportunity to renew the country's institutions.
cfr. E. Berlinguer (1978): "Austerità occasione per rinnovare l'Italia"
 - GREXIT (i.e. exit from the Euro area, and quite probably from the EU), enthusiastically advocated by some on the Left, and actively promoted by W. Schäuble and H.-W. Sinn, would be catastrophic in the short term, and ensure the country's decline in the longer term.

this presentation

- ❖ My primary question ...
 - ❑ *Why have the economic, social, and political effects of the crisis been more severe in Greece than elsewhere?*

- ❖ ... can be more easily tackled if decomposed into a set of secondary questions:
 - ❑ *Why has the recession been longer and deeper?*
 - ❑ *Why has the austerity not been equitable / consensual?*
 - ❑ *Why have political events played out as they have?*
 - ❑ *What (if anything) can be done now?*

- ❖ I cannot possibly tackle all these questions today (or ever) ...
- ❖ ... but I do hope to give you a flavour of certain key issues (and their interconnectedness).

context

facts

interactions

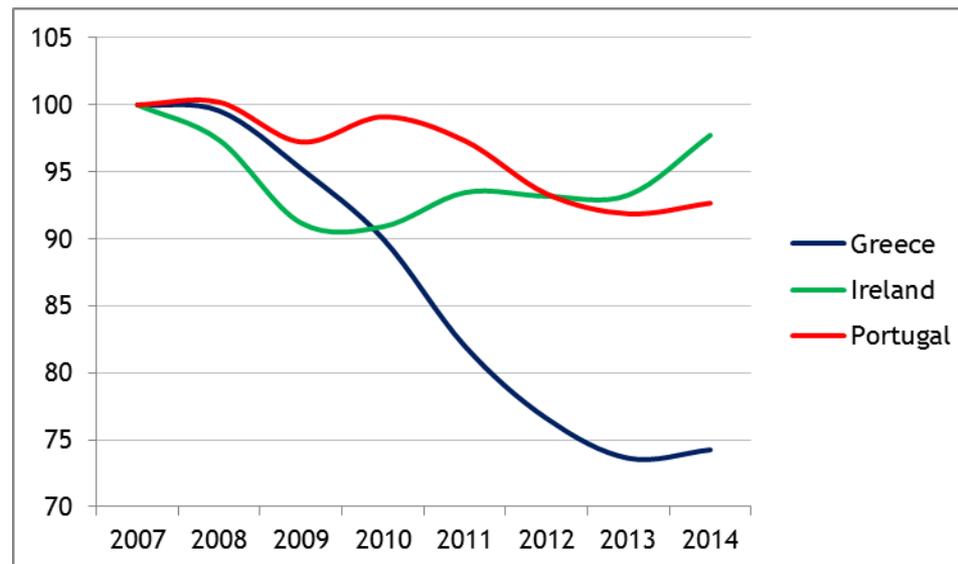
key issues

conclusions

economic effects

GDP contraction

- ❖ The bailouts coincided with mild downturn in IE (-2.6% in 2010-2013), deep recession in PT (-7.3% in 2010-2013), and accelerated contraction in EL (-22.0% in 2009-2014; overall -26.4% since 2007).



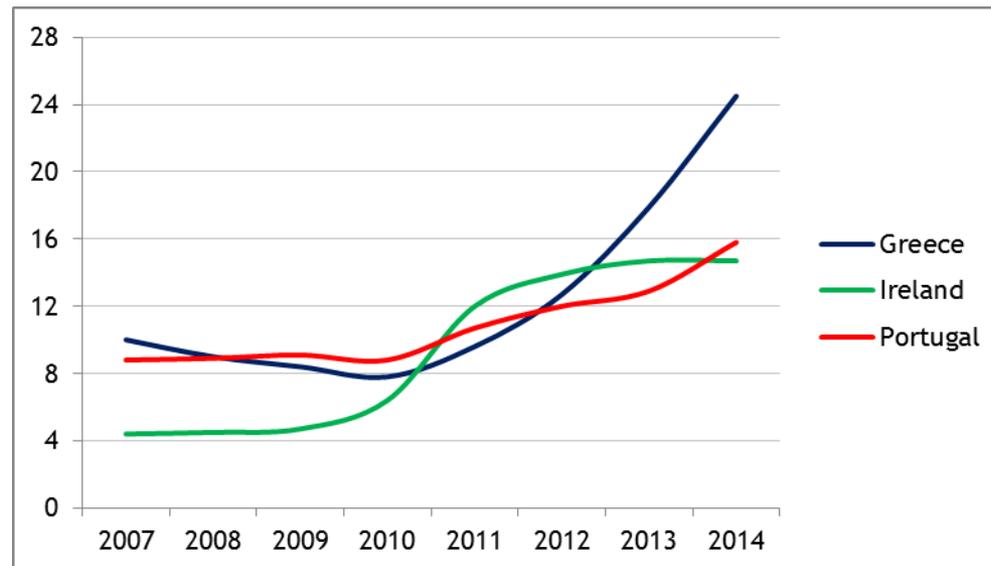
Gross domestic product at market prices, in real terms (2007=100).

Source: Eurostat.

labour market effects

unemployment

- ❖ GDP contraction caused unemployment to rise everywhere. But in Greece it rose more sharply, peaked later and is now much higher than in Ireland and Portugal: in January 2005 the unemployment rate stood at 25.7% (EL) vs. 13.8% (PT) and 10.0% (IE).



Unemployed workers (% workforce).

Source: Eurostat.

labour market effects

earnings

- ❖ Real wages also fell - both as a result of the recession (reduced demand for labour) and in the context of ‘internal devaluation’ (of which more later).

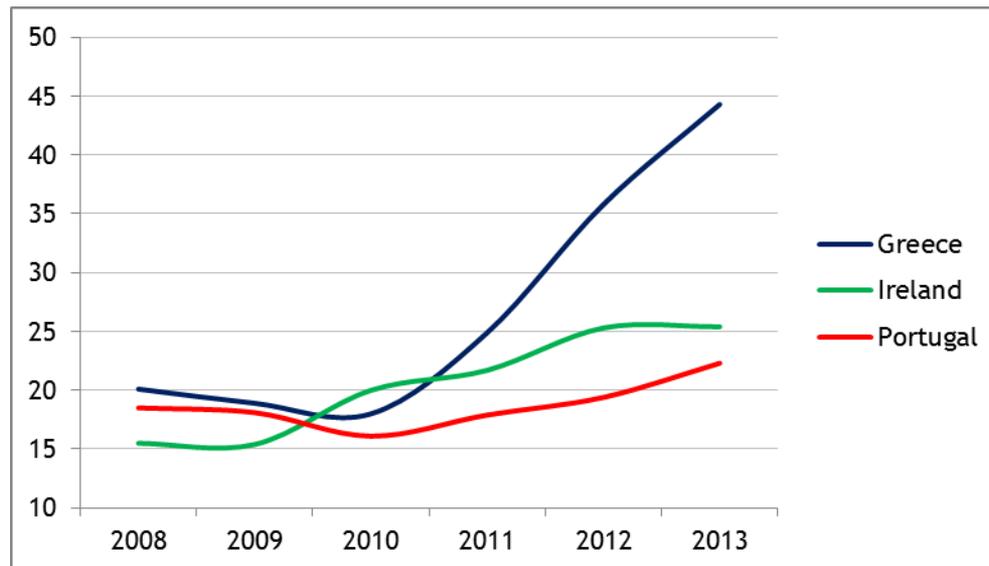
- ❖ In 2008-2013 the decline in gross earnings in Greece was twice as large as it was in Portugal, while in Ireland it was negligible (over the period).
 - ❑ Greece: -24.6%
 - ❑ Portugal: -12.3%
 - ❑ Ireland: -0.2%

Source: Eurostat data. See Myant & Piasna (2014) ‘Why have some countries become more unemployed than others?’. ETUI Working Paper 7 2014.

income distribution effects

relative poverty

- ❖ Poverty has risen almost everywhere. Fixing the poverty threshold at pre-crisis levels (in real terms) reveals that in Greece, 44.3% of population in 2013 were below the 2008 poverty line (vs. 22.3% in Portugal and 25.4% in Ireland).

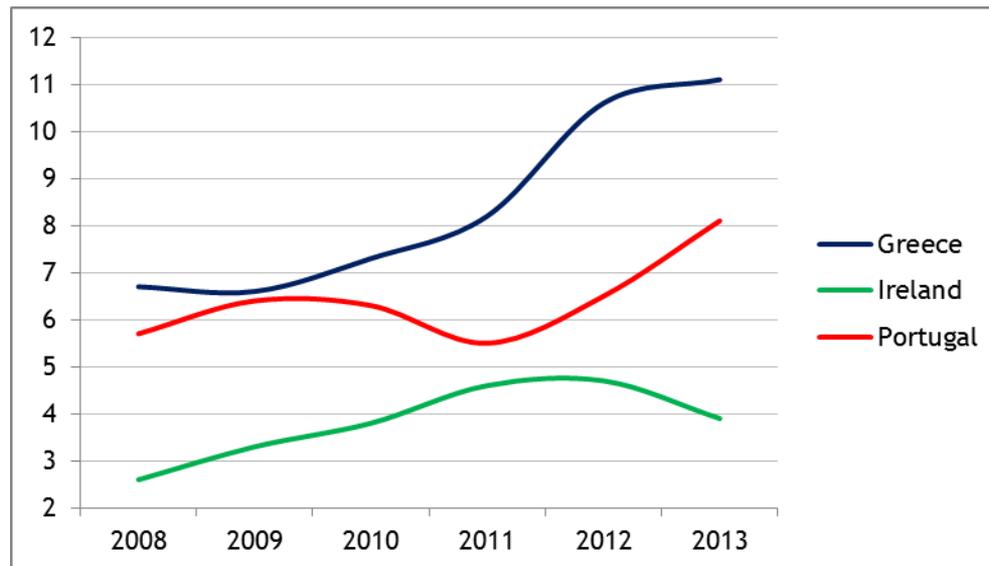


*Proportion of population with income below 60% of the 2008 median, in real terms.
Source: Eurostat.*

income distribution effects

extreme poverty

- ❖ Extreme poverty has also risen (although the poverty threshold - 40% of median - has fallen). In 2013 , it reached 11.1% in Greece (vs. 8.1% in Portugal and 3.9% in Ireland).

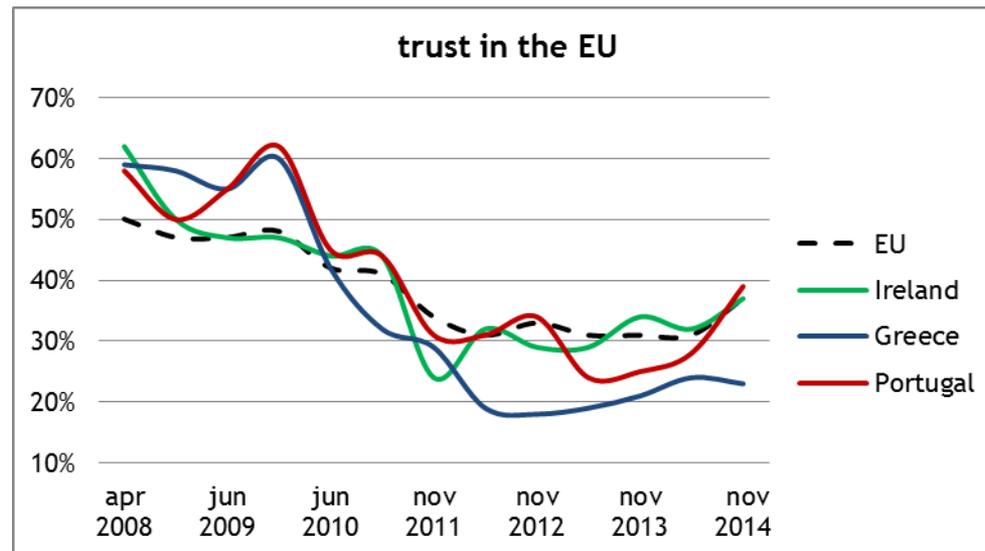


*Proportion of population with equivalent disposable income below 40% of median.
Source: Eurostat.*

political effects

trust in the EU

- ❖ In November 2014 trust in the EU had fallen in Greece to 23% (from 65% in September 2007). In Ireland and Portugal it had also declined, but stood above the EU average of 37%.

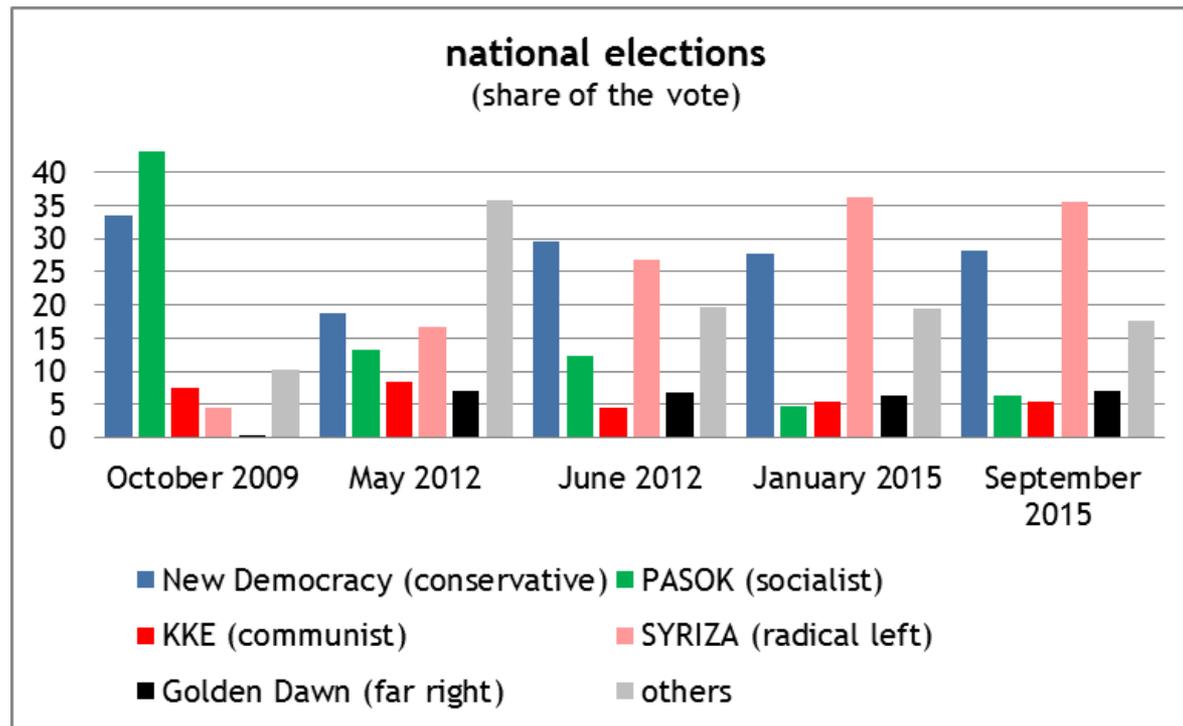


Source: Eurobarometer surveys.

political effects

2015 general elections

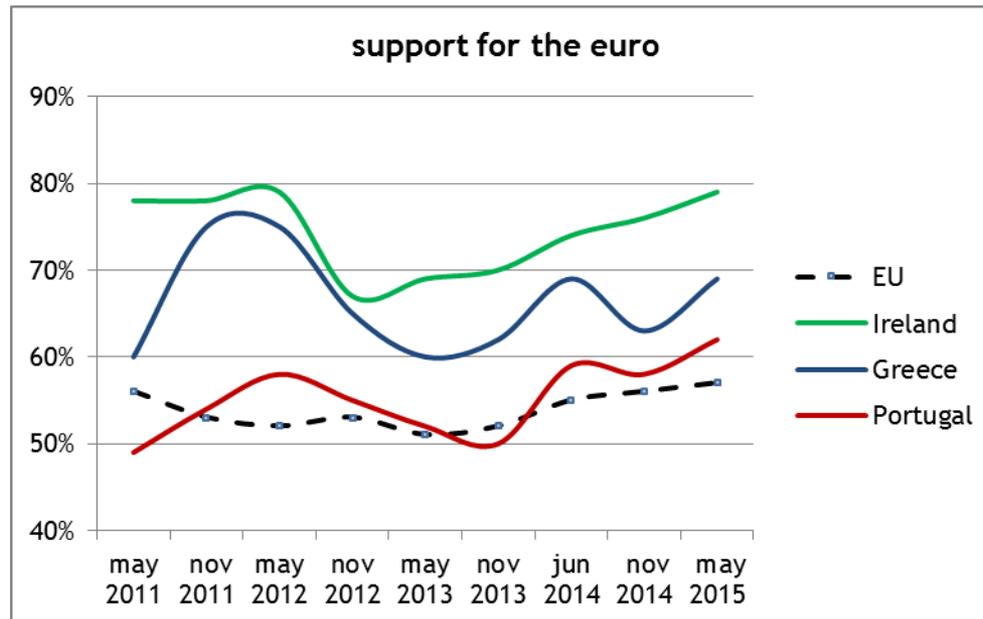
- ❖ At the general election of 25 January 2015, the radical Left (SYRIZA) won a relative majority (36.3%) of the vote, following which it formed a coalition government with the anti-austerity nationalists ('Independent Greeks').
- ❖ At the general election of 20 September 2015, the governing coalition lost 413,000 votes - but, on a low turnout, only 1.94% in percentage terms.
- ❖ Thanks to the electoral law: 39% of the vote = 52% of seats in Parliament.



political effects

support for the euro

- ❖ In May 2015, after five years of harsh austerity, trust in the common currency in Greece remained well above the EU average (69% vs 57%).
- ❖ (In Ireland and Portugal it was also high - and rising.)



Source: Eurobarometer surveys.

political effects

2015 referendum

- ❖ ... which may not be entirely irrelevant to the (otherwise rather incomprehensible) fact that in quick succession, Greek PM Tsipras:
 1. called a snap referendum on the austerity plan of 25 June 2015 proposed by the EU, the ECB and the IMF
 2. campaigned hard for a 'no' vote at the referendum of 5 July 2015
 3. won by a wide margin (61.3% vs. 38.7%)
 4. then went on to sign a harsher austerity plan (13 July 2015)

taking stock

- ❖ So, the economic, social, and political effects of the crisis have really been more severe in Greece than elsewhere.
- ❖ Specifically, as the evidence suggests:
 - ❑ The recession has been longer and deeper.
 - ❑ The austerity has been more inequitable.
 - ❑ The political situation has been more unstable.
- ❖ The question is: ‘why’

- context

- facts

- interactions

- key issues

- conclusions

interactions

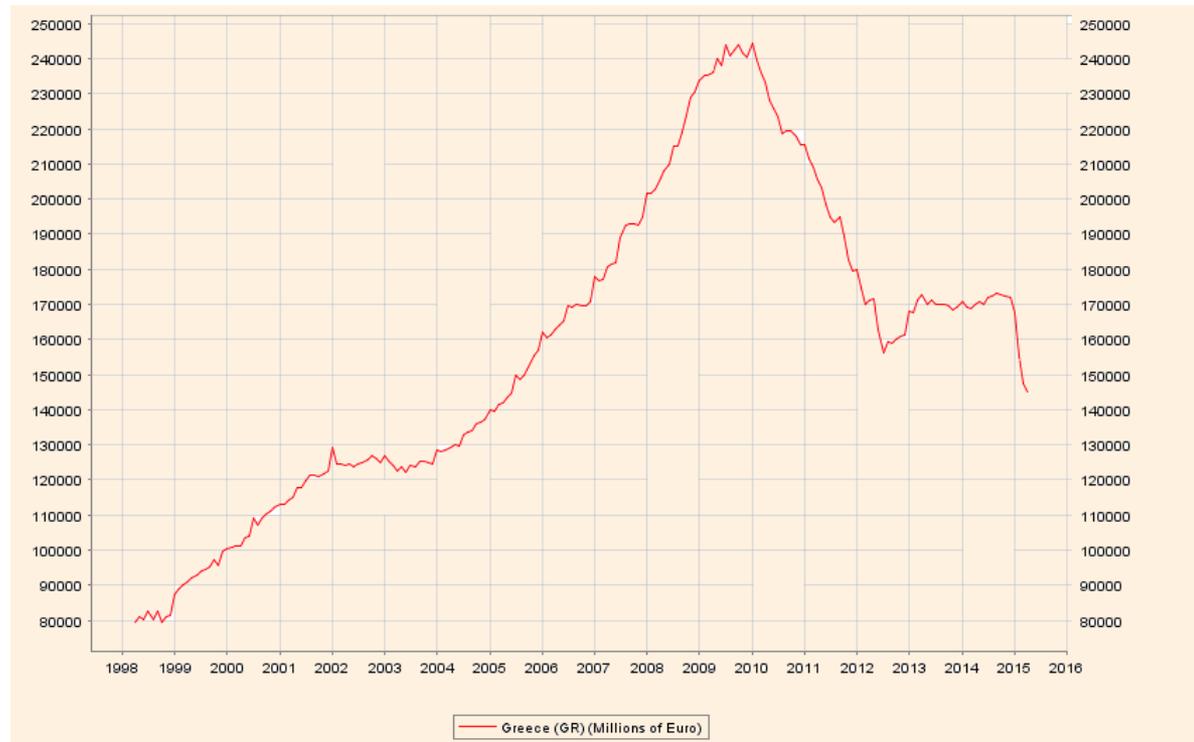
political economy

- ❖ Economic, social, and political aspects of the Greek crisis interacted in complex ways.
- The burden of fiscal adjustment and the costs of the recession were distributed unequally across population groups.
- Organized interests successfully protected (in relative if not absolute terms) their position at the expense of everybody else.
- The welfare state failed to protect the poor and the weakest of the victims of the crisis.
- The social emergency stoked political unrest.
- Political unrest made the recession deeper, fed speculation of GREXIT, and encouraged disinvestment and capital flight.

economic effects of political events

GREXIT as a (nearly) self-fulfilling prophecy

- ❖ Uncertainty undermines confidence: speculation about GREXIT, whether triggered by events at home (e.g. the negotiating stance of the Greek government in February-July 2015) or abroad (e.g. the Dauville declaration of October 2010), has shortened the odds that it might actually become reality.

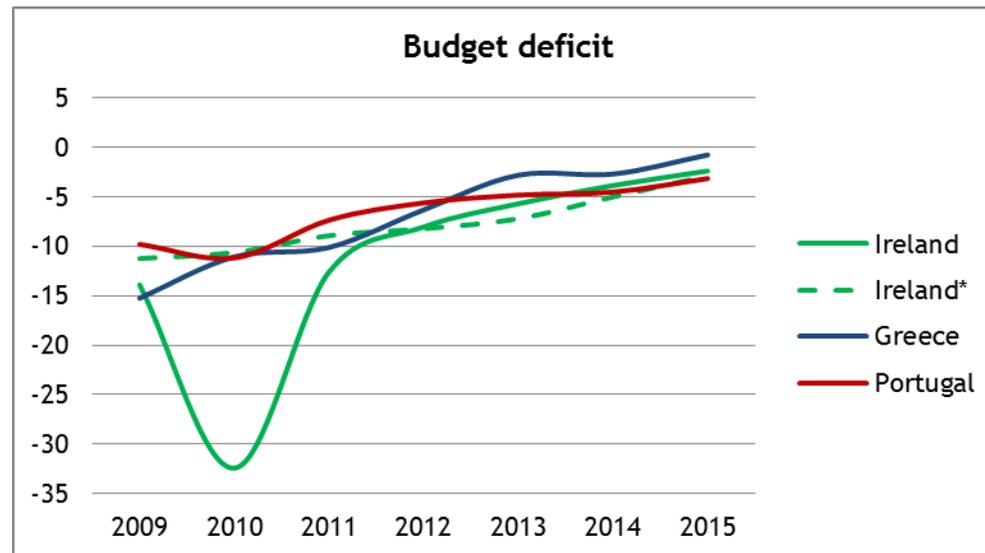


Source: ECB / Financial Times

fiscal effects

budget deficit

- ❖ In terms of deficit reduction (their immediate target), the bailout programmes can only be described as a huge success - in Greece perhaps more than in the other countries.



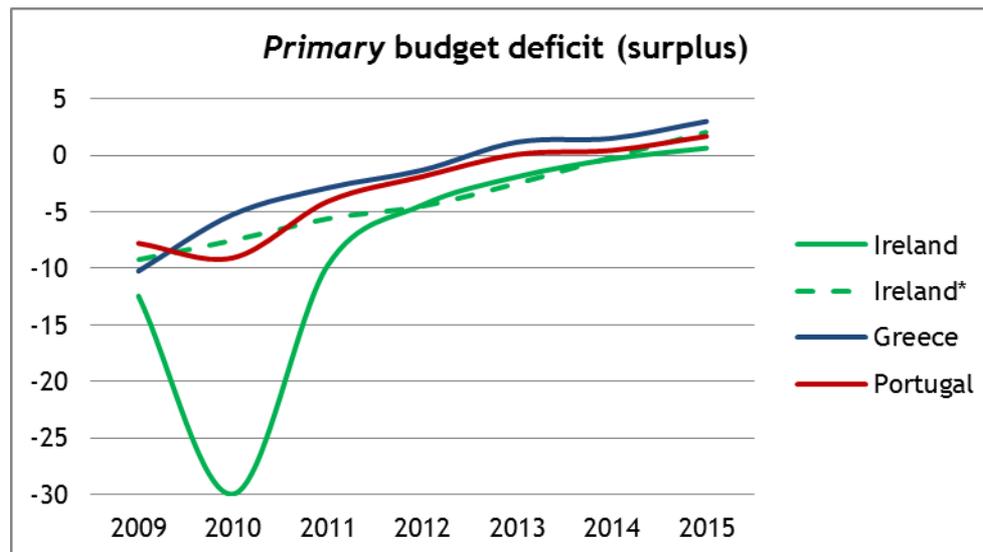
Budget deficit (% GDP). IE: incl. / excl. bank support.

Source: IMF.

fiscal effects

primary deficit

- ❖ The extent of Greece's fiscal consolidation effort is even more evident in terms of *primary* deficits (i.e. net of interest paid on debt, which is arguably beyond the control of domestic actors).



Budget deficit net of interest paid on debt (% GDP). IE: incl. / excl. bank support.
Source: IMF.

fiscal effects

consumption vs. investment

- ❑ In Greece, between 2009 and 2014 government expenditure was cut from €128 to €83 billion, while government revenue declined from €92 to €78 billion (by 35% and 15% respectively - in *nominal* terms).
- ❑ Given that the economy shrank significantly over that period, the share of government expenditure in GDP fell from 54.0% to 46.3%, while that of government revenue *rose* from 38.7% to 43.6%.
- ❑ In 2008-2013, private consumption decreased by 25.7% in real terms, i.e. more than public consumption (19.3%), while gross fixed capital formation fell by as much as 63.1%.

social effects

European Commission

- ❑ How were income losses shared across the population?
- ❑ [In Greece] *“incomes of the poorest individuals have suffered the most. Real income in the bottom quintile has declined the most and remains 30 points lower than in 2003.”* (p.65)
- ❑ [In Portugal] *“the incomes of poorer individuals improved considerably until 2009, before steep declines in 2010-2011. Nevertheless, incomes in all but the top quintile remain higher than or at similar level as in 2004 in real terms. Real incomes of most wealthy individuals have generally declined.”* (p.68)

Source: EU Employment and Social Situation Quarterly Review (September 2014)

social effects

microsimulation estimates

- According to our estimates, in Greece the income of the poorest 10% of the population in 2013 was 69.2% lower than the income of the poorest 10% of the population in 2009. In Portugal, it was 18.1% lower in 2013 relative to 2009.

Source: Matsaganis M. & Leventi C. (2014) The distributional impact of austerity and the recession in Southern Europe. South European Society and Politics 19 (3) 393-412.

- As a result of massive income losses at the bottom of the distribution, we estimate that 1 person in 7 in Greece in 2013 was unable to purchase a basket of basic necessities (i.e. just above destitution level) without dissaving or running into debt. The equivalent figure in 2012 was 1 in 9 (in 2009: no more than 1 in 45).

Source: Matsaganis M. & Leventi C. (2014) Poverty and inequality during the Great Recession in Greece. Political Studies Review 12 (2) 209-223 (and updates).

political determinants of social effects welfare state

- ❖ In principle, a well-designed system of social protection should be able to mitigate the social effects of an economic crisis.
- *“These are precisely the kinds of emergencies that welfare state programmes and institutions are designed to deal with, so that when a financial crisis turns up we have routine mechanisms [...] for coping with its consequences. Long lines of the unemployed caused by economic crises are the core business of the welfare state”*

Castles F.G. (2010) Black swans and elephants on the move: the impact of emergencies on the welfare state. Journal of European Social Policy 20 (2) 91-101.

political determinants of social effects

failings of the welfare state pre-crisis

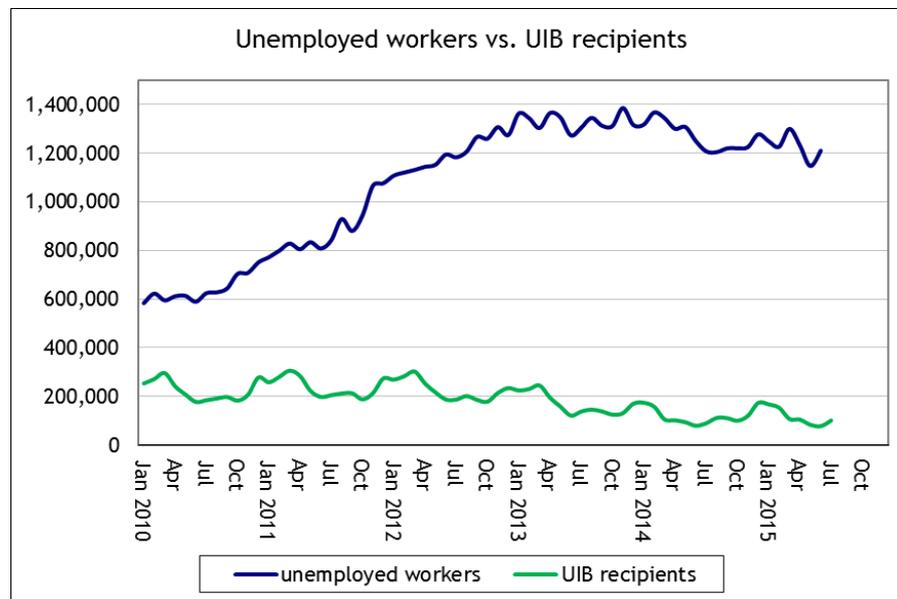
- ❖ In Greece the Great Recession was so deep and prolonged that any welfare state, however advanced and effective, would be severely tested.
- ❖ Let alone a welfare state like Greece's characterised by:
 - ❑ Gross inefficiencies / sustainability problems in core programmes (pensions and health)
 - ❑ Income support and social care to the poor and other vulnerable groups neglected
 - ❑ Serious gaps in the social safety net.
- ❖ So, when the economic crisis hit the country, the welfare state failed to rise to the occasion.

See Matsaganis M. (2011) The welfare state and the crisis: the case of Greece. Journal of European Social Policy 21 (5) 501-512.

automatic stabilisers

receipt of unemployment benefit (in 2010-2015)

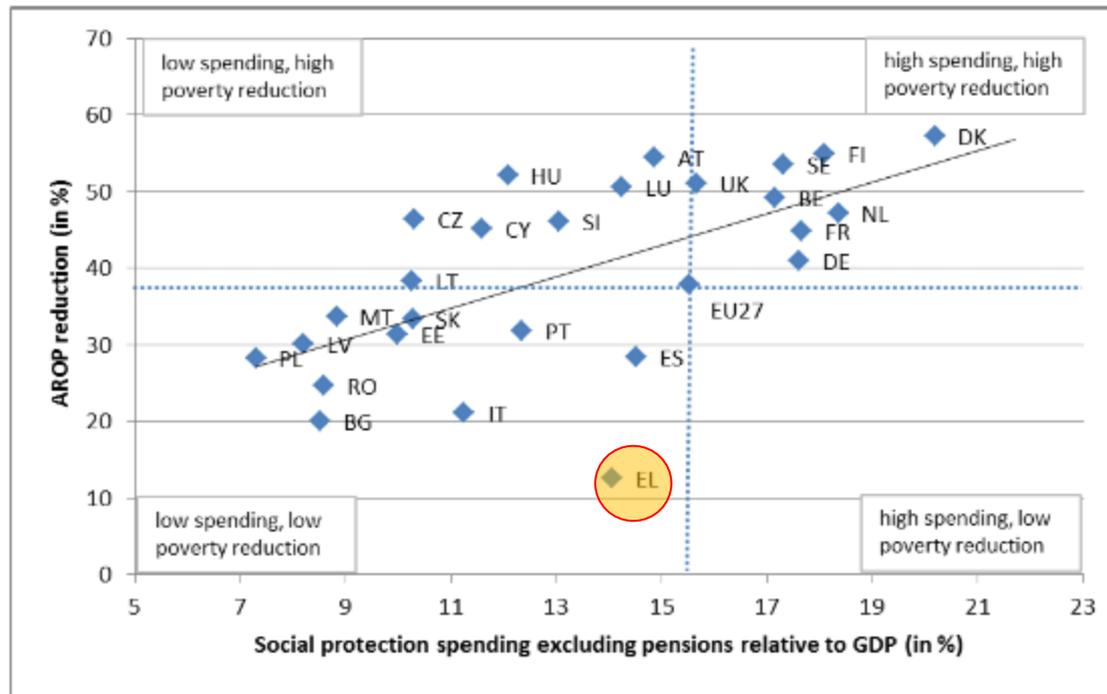
- ❖ The failure to protect the victims of the crisis is most evident in the declining coverage rate of unemployment benefit.
- ❖ While the number of unemployed workers sky-rocketed, the number of recipients of unemployment insurance benefit (the main income support scheme in the event of job loss) fell.
- ❖ As a result of that, the coverage rate in June 2015 was a mere 6.4%.



Source: *ElStat and OAEA (Public Employment Service).*

automatic stabilisers anti-poverty effective of social benefits

- ❖ Greece is an outlier in the spending / poverty reduction nexus.

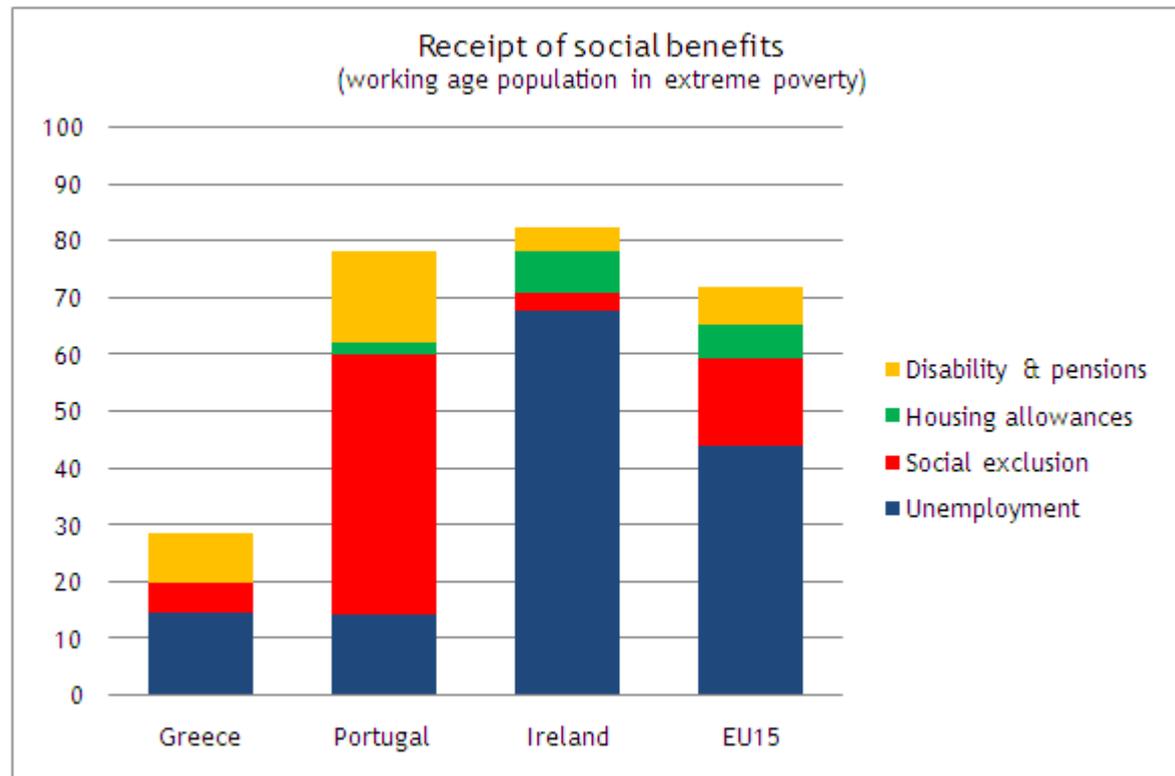


Source: ESSPROS and EU-SILC.

automatic stabilisers

gaps in the social safety net

- ❖ In Greece, most people in extreme poverty are not in receipt of income support. This is not the case in Portugal nor Ireland.

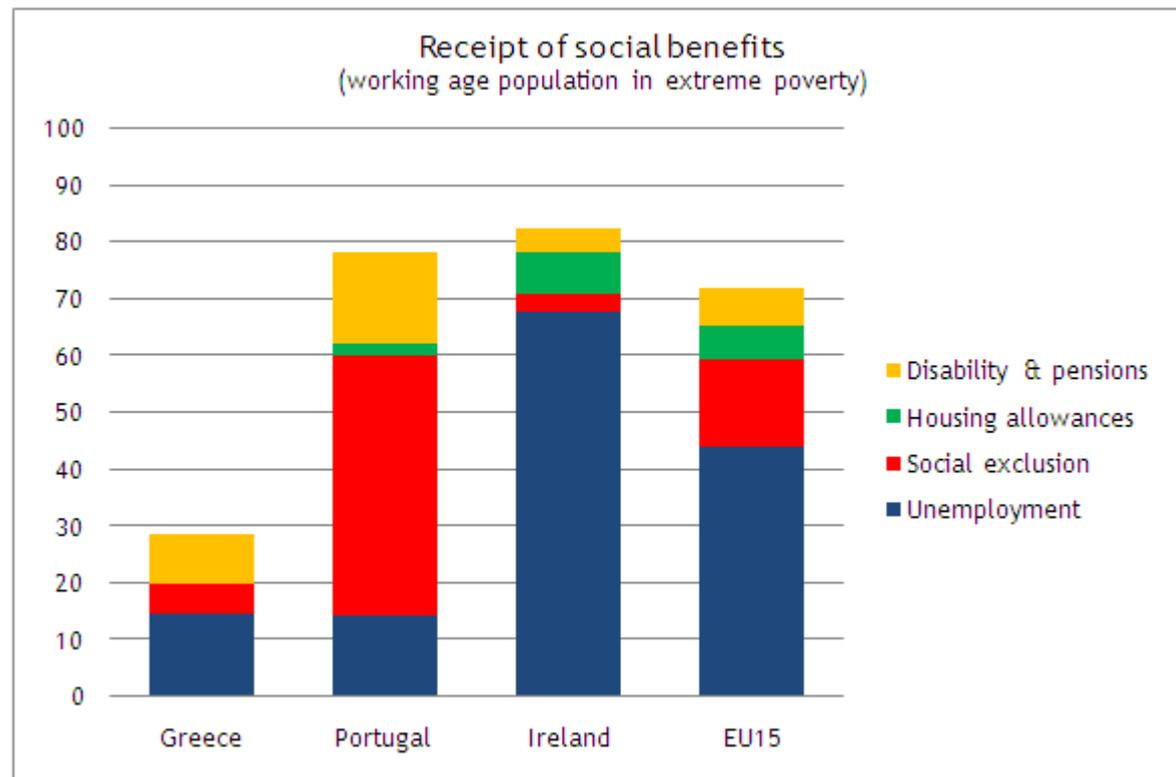


Source: Matsaganis M., Ozdemir E. & Ward T. (2013) *The coverage rate of social benefits*. Research Note 9/2013. Social Situation Observatory, European Commission.

automatic stabilisers

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Source: Matsaganis M., Ozdemir E. & Ward T. (2013) *The coverage rate of social benefits*. Research Note 9/2013. Social Situation Observatory, European Commission.

effective retirement age (in March-May 2015)

- ❖ Meanwhile, the number of pensioners keeps growing (to 2.7m)
- ❖ as the number of workers continues to shrink (to 3.6m)
- ❖ ... while retiring at a tender age remains quite easy
- ❖ 25% of all retirees in spring 2015 were aged below 55 (in the civil service: 34%)

age at retirement	all retirees		civil servants	
	no.	%	no.	%
<25	1,080	4%	219	4%
26-50	1,935	7%	532	9%
51-55	4,108	14%	1,319	22%
56-61	8,338	29%	2,135	36%
62-67	5,789	20%	912	15%
68-73	3,092	11%	292	5%
>73	4,038	14%	601	10%
unknown	16	0%	0	0%
total	28,396	100%	6,010	100%

Source: Ministry of Labour; own calculations (data for March-May 2015).

pension benefit cuts (in 2010-2014)

- ❖ Pensions were cut significantly under austerity.
- ❖ Low-income pensioners were not fully protected ...
- ❖ ... but higher pensions were reduced by far more.

level of monthly pension (in 2010)	annual pension income in real terms (€)		
	2010	2014	change (%)
€600 pcm	8,400	7,069	-15.8%
€800 pcm	11,200	9,079	-18.9%
€1.300 pcm	18,200	13,898	-23.6%
€2.200 pcm	30,800	19,611	-36.3%
€2.500 pcm (age >65)	35,000	20,500	-41.4%
€2.500 pcm (age <55)	35,000	19,059	-45.5%

Source: Ministry of Labour; own calculations

political determinants of social effects

policy reactions to the social emergency

- ❖ When the crisis exploded, the Greek welfare state found itself between a rock and a hard place:
 - ❑ the recession increased the demand of social protection
 - ❑ the austerity reduced the supply of social protection
- ❖ On paper at least, the solution was obvious: reform programmes, improve efficiency, protect the weakest.
- ❖ In practice, the policy debate continued to be dominated by the protests of organized interests (incl. providers of public services, and those entitled to over-generous pensions)
- ❖ So, policy makers chose ‘the path of least resistance’: little (if anything) was done to protect users of essential services, or to improve support to low incomes, or to strengthen the social safety net in other ways.

explaining political developments

- ❖ No time to go through that now - beyond a few hints:
- ❖ A strong legacy *worked against* a positive reaction to the crisis:
 - ❑ the weight of history and the role of national exceptionalism
 - ❑ the resurgence of populism and ‘soothing narratives’
 - ❑ the persistence of anti-western sentiments across the political spectrum
 - ❑ a high tolerance for ‘direct action’ and/or political violence
 - ❑ the weakness of moderate left and liberal centrist reformism

Doxiadis A. & Matsaganis M. (2013) National populism and xenophobia in Greece. In: Populist fantasies: European revolts in context (edited by C. Fieschi, M. Morris, L. Caballero). London: Counterpoint.

explaining political developments (cont'd)

- ❖ Recent developments *obstructed* a positive reaction to the crisis:
 - ❑ a widespread feeling of national humiliation (fed by the contemptuous attitude and heavy-handed approach of international actors), and ensuing nationalist backlash
 - ❑ the severity of the recession
 - ❑ the intensity of the ‘new social question’
 - ❑ the hollowing of democracy (hundreds of pages of legislative changes presented to the Greek government and national parliament to ‘debate’ and approve at dazzling speed)

- ❖ All this has made life difficult for pro-European reformers ...
- ❖ ... and has turned the Greek crisis into a great opportunity for demagogues of all political hues.

context

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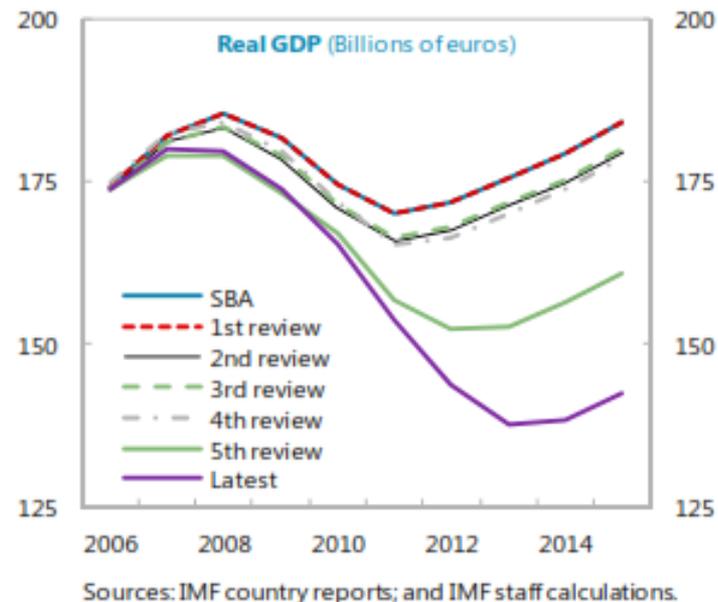
the usual suspects

- ❖ A recent IMF report quite candidly listed successes and failures of the ‘Greek Programme’.
- ❖ *Successes*
 - ❑ Strong fiscal consolidation.
 - ❑ Greece remained in the Euro area.
 - ❑ Contagion averted.
- ❖ *Failures*
 - ❑ Market confidence not restored.
 - ❑ Banking system lost 30 percent of its deposits.
- ❑ Recession much deeper-than-expected with exceptionally high unemployment.
- ❑ Public debt still too high.
- ❑ Competitiveness improved somewhat, but structural reforms stalled; productivity gains proved elusive.
- ❑ Baseline macro projections can be criticized for being too optimistic.

macro projections

- ❖ Initial projections really did turn out to be over-optimistic

In terms of growth:

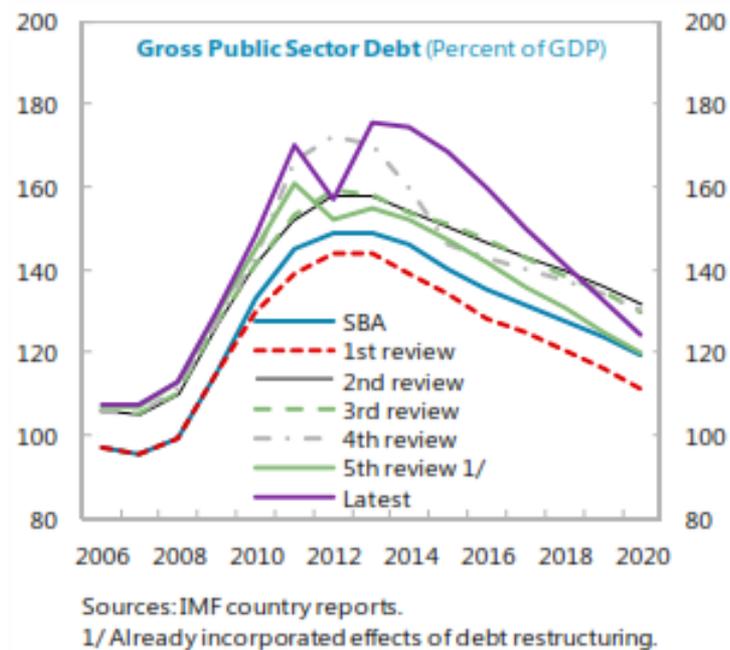


Source: IMF (2013) *Greece: Ex Post Evaluation of Exceptional Access under the 2010 Stand-By Arrangement*. IMF Country Report No. 13/156 (June 2013). Washington DC: International Monetary Fund.

macro projections (cont'd)

- ❖ Initial projections really did turn out to be over-optimistic

In terms of
debt:

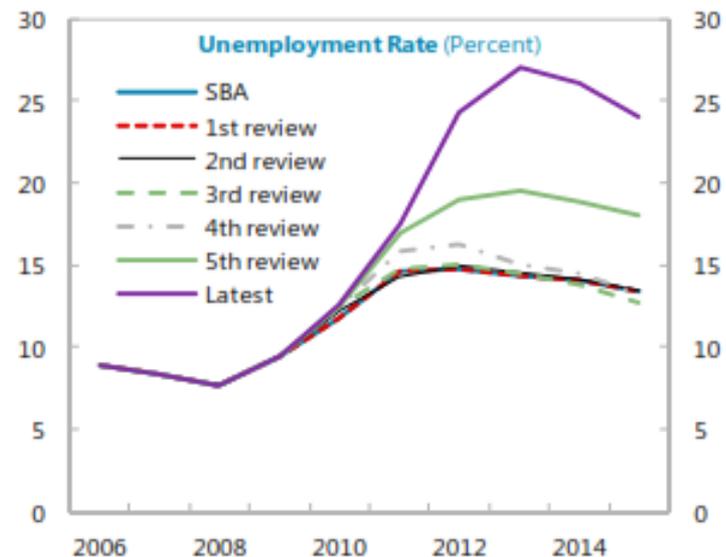


Source: IMF (2013) *Greece: Ex Post Evaluation of Exceptional Access under the 2010 Stand-By Arrangement*. IMF Country Report No. 13/156 (June 2013). Washington DC: International Monetary Fund.

macro projections (cont'd)

- ❖ Initial projections really did turn out to be over-optimistic

In terms of unemployment:



Source: IMF (2013) *Greece: Ex Post Evaluation of Exceptional Access under the 2010 Stand-By Arrangement*. IMF Country Report No. 13/156 (June 2013). Washington DC: International Monetary Fund.

fiscal multipliers

- ❖ In fact, the Greek experience forced a little rethink at IMF (bitterly contested by Commissioner for Economic and Monetary Affairs O. Rehn, who thought it was ‘unhelpful’):
- ❖ Bailout programmes had assumed at the outset a fiscal multiplier of about 0.5
 - *i.e. a reduction in government spending or increase in taxes by \$10 is associated with a loss of \$5 in terms of GDP*
- ❖ IMF now thinks a range of 0.9 to 1.7 is more realistic
 - *i.e. a reduction in government spending or increase in taxes by \$10 is associated with a GDP loss of \$9 to \$17*

Source: Blanchard O. & Leigh D. (2013) Growth forecast errors and fiscal multipliers. IMF Working Paper 13/1. Washington: International Monetary Fund.

causes of high multipliers

- ❖ But this only begs the question of why this was the case: why was the fiscal multiplier so high in Greece?

- ❖ In fact, the size of the multiplier will depend on (i) the savings rate, (ii) the average tax rate, and (iii) export performance:
 - ❑ the lower the savings rate
 - ❑ the lower the average tax rate
 - ❑ and the lower the degree of trade openness (in terms of exports) - then
 - ❑ the higher the fiscal multiplier.

See Alcidi C. & Gros D. (2012) Why is the Greek economy collapsing? A simple tale of high multipliers and low exports. CEPS Commentary (21 December 2012). Brussels: Centre for European Policy Studies.

low savings

- ❖ The savings rate did fall throughout Southern Europe pre-crisis.
- ❖ EMU itself was an important part of the story.
- ❖ As interest rates fell throughout the Euro area, the effect was more pronounced in the South (where interest rates had been highest).
- ❖ Both governments and households had an incentive to borrow and spend - and, by and large, they did.
- ❖ In Greece, while net private savings also declined, it was the 'Public Sector Borrowing Requirement' that went up more steeply (especially under the conservatives in 2004-2009).
- ❖ In Ireland (and Spain), governments were 'virtuous' insofar as they avoided large deficits, but less so in that they actively promoted (or failed to prevent) a housing bubble.

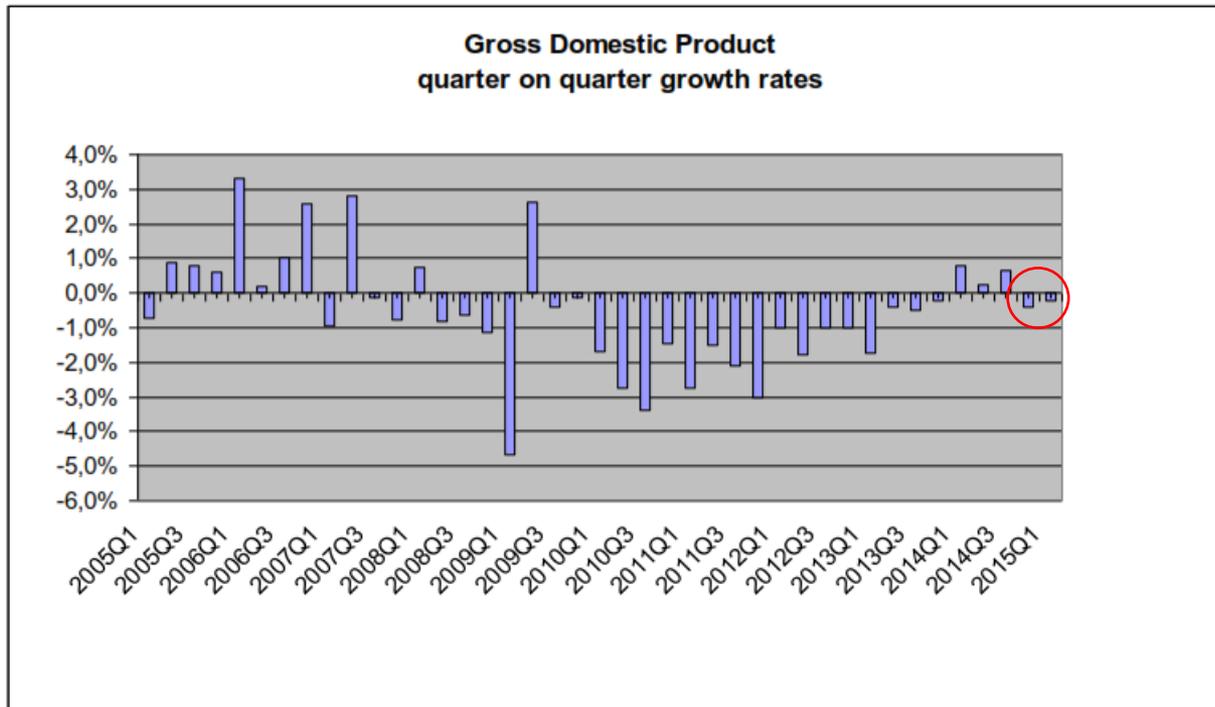
low savings (cont'd)

- ❖ But a profligate government (pre-crisis) is only part of the explanation for the role of savings in the length and depth of the recession in Greece.
- ❖ Between early 2010 and mid-2012 savings in Greek banks (in accounts held by Greek residents) declined from almost €250 billion to around €160 billion.
- ❖ Why?
 - Partly for good economic reasons (households dissave in a recession in order to soften the effect of falling income on consumption).
 - Partly for bad political reasons (lingering uncertainty as to the place of Greece in the Euro area).

GREXIT

- ❖ Political instability at home fed alarmist talk abroad about an impending Greek exit from the Euro area - but was also fed by it!
- ❖ European policy makers seemed to entertain the idea that the Euro area would be better off without Greece for long enough to virtually destroy investors' confidence in prospects for the Greek economy. (While at the same time they pressed Greek governments to engage in massive fiscal consolidation.)
- ❖ All this went on until ECB head M. Draghi famously pledged to do "whatever it takes to preserve the Euro" (July 2012).
- ❖ Speculation about GREXIT made a spectacular comeback in December 2014, when it became increasingly clear that there would be - yet another - political crisis in Greece.
- ❖ Protracted negotiations between the new Greek government and (what used to be called) the IMF-EU-ECB 'Troika' plunged the economy back into recession after the tentative recovery of 2014.

the (new) Greek recession



Source: ElStat.

tax evasion

- ❖ Greek corruption has become one of the most popular explanation for lack of progress in fighting tax evasion.
- ❑ Christine Lagarde, Managing Director of the International Monetary Fund, to *The Guardian* (the British daily):
 - ❑ *Lagarde: “Do you know what? As far as Athens is concerned, I also think about all those people who are trying to escape tax all the time. All these people in Greece who are trying to escape tax.”*
 - ❑ Guardian: Even more than she thinks about all those now struggling to survive without jobs or public services?
 - ❑ *Lagarde: “I think of them equally. And I think they should also help themselves collectively.”*
 - ❑ Guardian: How?
 - ❑ *Lagarde: “By all paying their tax. Yeah.”*
- ❑ (The Guardian, Friday 25 May 2012)

tax evasion (cont'd)

- ❖ Tax evasion really *is* higher in Greece (and Italy) than in Ireland and Portugal (and Spain).
- ❖ Income under-reporting is considered to be pervasive among the self-employed.
- ❖ A recent study found that the true incomes of the liberal professions and other self-employed workers in Greece are on average 92% higher than what is actually reported to the tax authorities.

Artavanis A., Morse A. & Tsoutsoura M. (2012) Tax evasion across industries: soft credit evidence from Greece. Chicago Booth Paper No. 12-25.

- ❖ This suggest a rate of under-reporting of 48% under-reporting, broadly in line with our own estimate of 38%-43%.

Matsaganis M., Leventi C. & Flevotomou M. (2012) The crisis and tax evasion in Greece: what are the distributional implications? CESifo Forum 13 (2) 26-32.

- ❖ This is huge - but not out of line with estimates for the US.

tax evasion (cont'd)

- ❖ For instance, the analysis of US tax audit data collected under the Taxpayer Compliance Measurement Program (TCMP) in 1988 estimated the rate of under-reporting of self-employment earnings at 58.6% (Slemrod and Yitzhaki 2002).
- ❖ Similarly, the analysis of more recent data from the successor to TCMP, the National Research Program (NCP) showed that:
 - ❑ *"Only 1 percent of wages and salaries are underreported. Of course, wages and salaries must be reported to the IRS by those who pay them; in addition, they are subject to employer withholding. Self-employment business income is not subject to information reports, and its estimated noncompliance rate is sharply higher. An estimated 57 percent of nonfarm proprietor income is not reported."*

Slemrod J. (2007) Cheating ourselves: the economics of tax evasion. Journal of Economic Perspectives 21 (1) 25-48.

tax evasion (cont'd)

- ❖ Not surprisingly, the issue of tax evasion was flagged up from the beginning by international organizations as key to the success of the Greek programme (and as key reason for its failure):
 - ❑ *“Advancing tax administration reform is a crucial priority to limit risks of revenue shortfalls, and also to increase fairness in sharing the adjustment burden” (IMF 2010)*
 - ❑ *“Fiscal consolidation was held back by a less than successful fight against tax evasion” (European Commission 2011)*
 - ❑ *“If Greece collected its VAT, social security contributions and corporate income tax with the average efficiency of OECD countries, tax revenues could rise by nearly 5% of GDP” (OECD 2011).*

tax evasion (cont'd)

- ❖ Armed with the conviction that fighting tax evasion is a matter of (a) political will and (b) administrative capacity, the Troika applied pressure to the Greek government to introduce the new office of ‘General Secretary of Government Revenue’ at the Ministry of Finance.
- ❖ The new office was designed to be immune from political pressure: its holder would be selected on merit, appointed on a 4-year fixed-term (not coinciding with the electoral cycle), and would enjoy wide powers to enforce policy.
- ❖ Legislation was duly passed, and the right person was appointed. But the government immediately engaged in behind-the-scenes efforts to limit his jurisdiction.
- ❖ Eventually, in the context of mounting discontent with rising tax pressure, and pressure by government MPs “to deal with it”, the General Secretary was forced to resign prematurely.

tax evasion (cont'd)

- ❖ But what the evidence from the US (and elsewhere) suggests is that perhaps *the* key determinant of the size of tax evasion is the structure of the labour market.
- ❖ Self-employed workers evade taxes everywhere (and apparently less in Greece than elsewhere).
- ❖ Other things being equal, tax compliance will be lower where the share of self-employed workers is higher.
 - In the US, the self-employed make up 8% of the workforce.
 - In the Euro area, as a whole, the figure is 14.6%.
 - In Ireland: 16.5%
 - In Portugal: 19.6%
 - In Greece: 30.4%

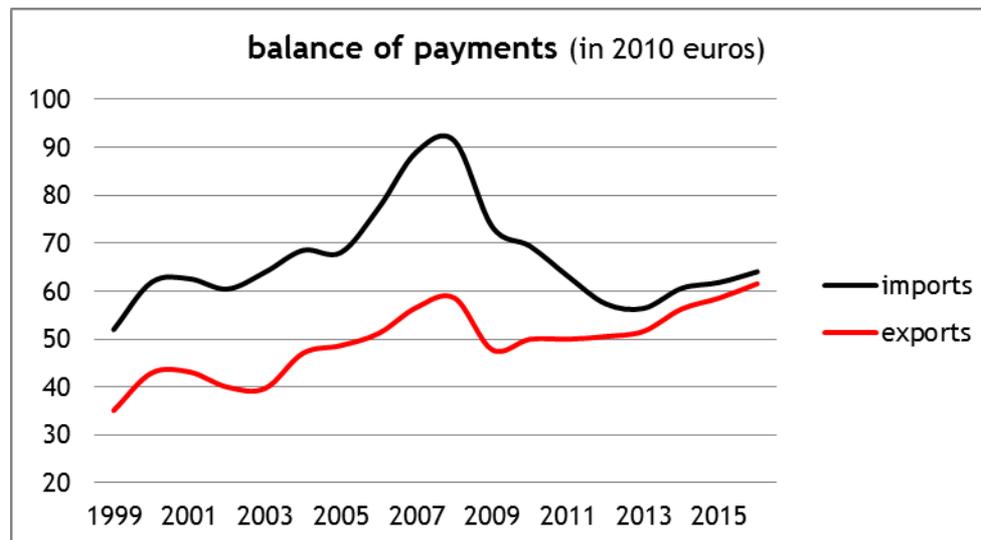
Source: Eurostat (data for 2014q2).

tax evasion (cont'd)

- ❖ In other words, the structure of the economy and of the labour market places significant limits on how much progress can be realistically achieved on that front.
- ❖ This is not to argue that fighting tax evasion and improving tax administration should not be a priority - it certainly should.
- ❖ It is to say that fighting tax evasion is less an issue of political will and/or administrative capacity, than a structural one.
- ❖ It is the growth model that matters most.

the 'other' deficit

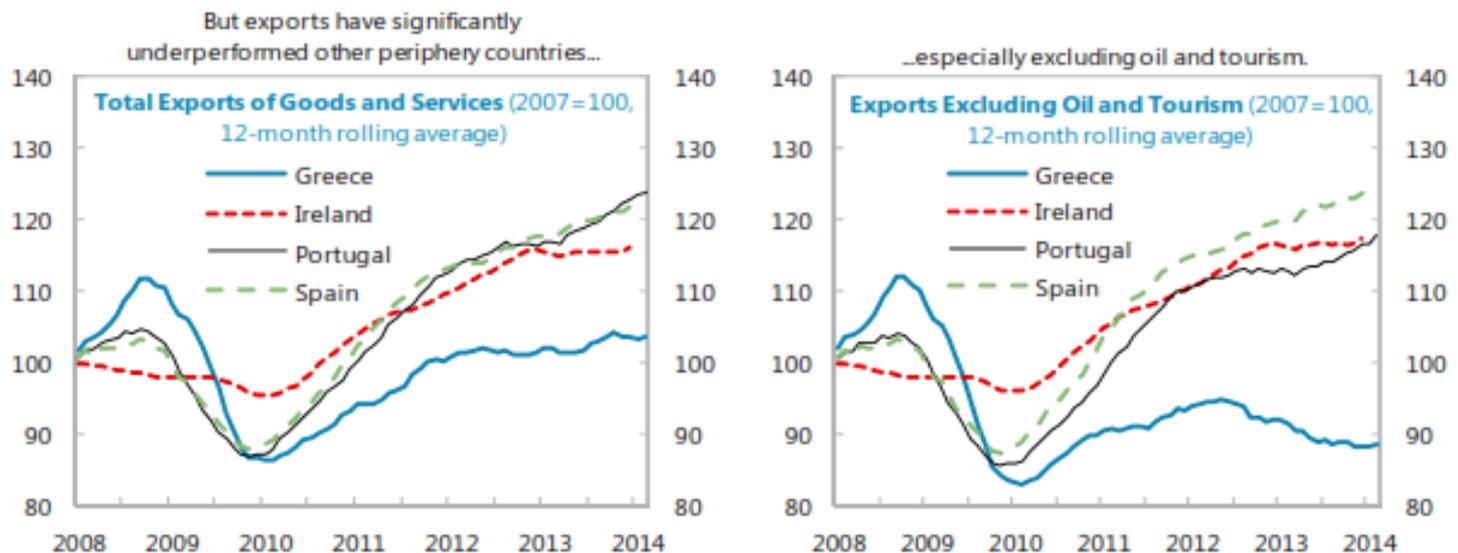
- ❖ Pre-crisis, the loss in competitiveness was manifest in a massive balance-of-payments problem, with the current account deficit reaching 14.9% of GDP in 2008.
- ❖ In recent years, Greece's current account balance improved spectacularly (to +1.2% in 2014).
- ❖ But on closer inspection, the correction was brought about more by a reduction in imports than by an increase in exports.



Source: AMECO, European Commission.

export performance

- ❖ Exports are an important part of the story: at times of austerity, a country's strong export performance may (partly) compensate for weak domestic demand.
- ❖ But this has happened less in Greece than in the other 'programme countries'.



varieties of capitalism

- ❖ But why has export performance been historically lower in Southern Europe? And why is it still lagging in Greece?
- ❖ Varieties of Capitalism scholars have pointed out that the roots of the crisis are linked to institutional asymmetries between political economies.
- [Pre-EMU] “the governments of northern Europe have often taken advantage of the institutional capacities for coordination in their political economies to pursue strategies based on export-led growth, [while] the governments of southern Europe have been more inclined to pursue demand-led growth, i.e. strategies based on the expansion of domestic demand. [...] Because expansionary macroeconomic policies tend to raise rates of inflation, in the years before EMU many of those governments used periodic devaluations of their exchange rates to lower the price of exports and raise the price of imports, thereby off-setting the effects of inflation on the trade balance.”
- [Post-EMU] “For the political economies of southern Europe, [...] entry into monetary union also called into question the viability of the demand-led growth strategies on which these countries had long relied, because they could no longer devalue to offset the accompanying inflation. [...] The confidence effects generated by the new union quickly lowered the cost of capital in southern Europe; and, to invest the balance-of-payments surpluses building up in the north, the banks of northern Europe sent large flows of funds to southern Europe. Thus, even when the governments of the south did not adopt an expansionary fiscal stance, cheap credit fuelled the expansion of domestic demand.”

the growth model

- ❖ The Varieties of Capitalism literature shifts attention to the structural issues behind the Euro crisis.
- ❖ At the same time, an emergent domestic literature focusing on the country's growth model provides crucial insights on the roots of the Greek crisis, and on why the recession was so much deeper and more prolonged in Greece.
- ❖ Recent work (e.g. by Doxiades 2014) explains the steady slide in competitiveness by emphasising a gradual and almost imperceptible shift from tradeables to non-tradeables, tacitly supported by political actors across the spectrum, in the context of structural weaknesses such as low firm size.
- ❖ This literature also sheds light on a variety of relevant factors, such as the role of the state as a guarantor of employment, earnings and profits via public procurement, product market regulation, and a strategic tolerance of low tax compliance.
- ❖ It also highlights serious faults in standard narratives as to the nature of obstacles to modernization in Greece and elsewhere.

organized interests

- ❖ For instance, much of the relevant debate has centred on the role of labour unions.
- ❖ Unions really *were* responsible for blocking long overdue pension reform pre-crisis.
- ❖ But what observers often fail to realize is just how weak unions are outside their traditional strongholds in the civil service, the ‘nationalized industries’, and banking (largely state-owned until the mid-1990s).

union strength

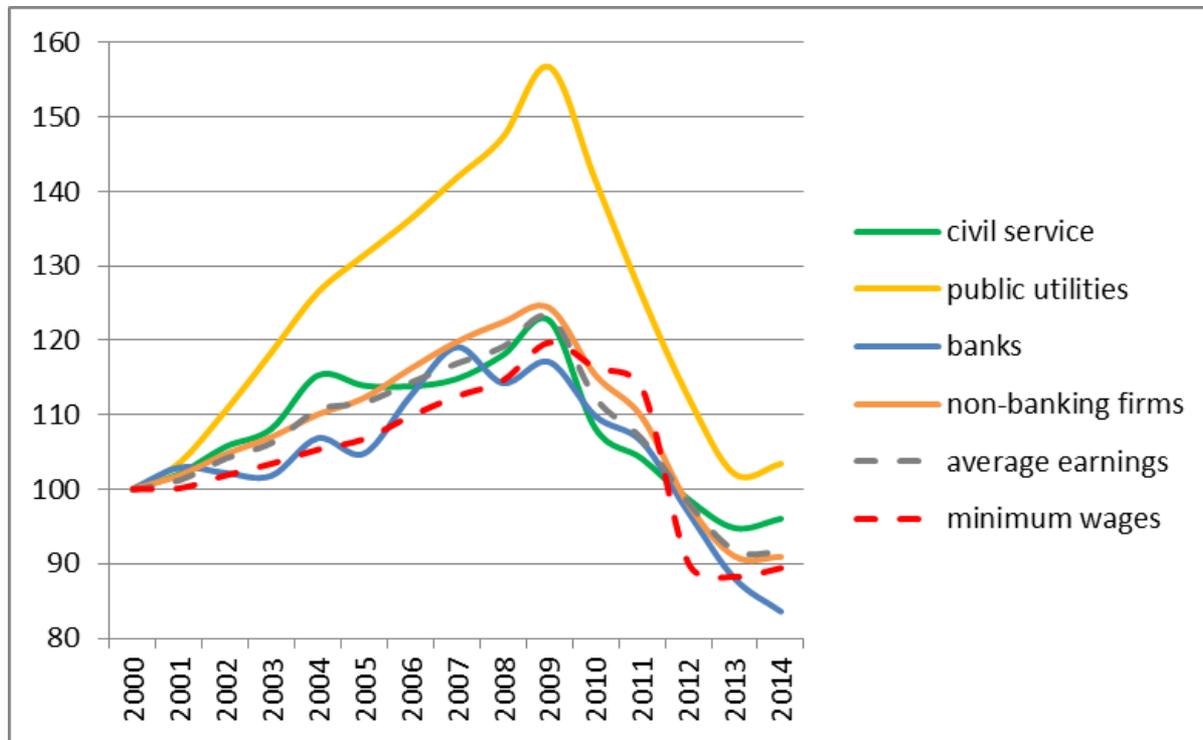
- ❖ Outside their traditional strongholds, e.g. in the tradeables sector, unions had already been weak (pre-crisis).

	union density	% of all workers
banks	76.2	2.3
civil service	67.4	15.7
public utilities	53.8	4.6
non-banking firms	15.6	76.1

Source: Matsaganis M. (2007) Union structures and pension outcomes in Greece. British Journal of Industrial Relations 45 (3) 537-555.

union strength

- ❖ Real earnings growth in the tradeables sector had been more modest (pre-crisis).



Source: Bank of Greece.

organized interests (cont'd)

- ❖ This pretty basic point seems to be completely lost on certain policy makers (and scholars). By way of illustration:
 - “The tight conditionality of bail-out programmes—which exceeds conditionality in IMF programmes – aims precisely at **cutting the ties between political and economic actors** in MMEs [i.e. Mixed Market Economies]. This is not to imply that the German government (and EU Commission) has a clear understanding of the academic debates on CMEs and MMEs. It is more to suggest that actors have an intuitive understanding of where political veto points are rooted in the Greek political economy. (This point mainly reflects anecdotal evidence gathered from conversations with German policy-makers.)
 - “In line with this reasoning, economic adjustment programmes, for instance in Greece, contain measures on labour market deregulation, **not because there is an expectation that these measures will improve competitiveness**, but because policy-makers in the Troika believe that the protection and compensation mechanisms must be broken for the effectiveness of financial transfers.
 - “In Greece for instance, wage bargaining deregulation has been part of the adjustment package by the Troika, which [...] would be unlikely to fundamentally change labour costs in Greece. However, **the change in the regulatory set-up of wage setting institutions is seen as an important political measure rather than an economic one**. For policy-makers in debtor countries, it is, therefore, not the economic adjustment process that is a precondition for financial integration, but the political process of detaching economic actors from the policy process.”

organized interests (cont'd)

- ❖ So, German policy makers' "intuitive understanding of where political veto points are rooted in the Greek political economy", no doubt shared by O. Rehn and others, has justified sweeping labour market reforms.
- ❖ These included a cut in the minimum wage by 22% in nominal terms in February 2012 (-32% for young workers), and sweeping deregulation of labour market institutions.
- ❖ But the obstacles to a dynamic (and inclusive) labour market were misdiagnosed: the Greek labour market was (and is) not so much 'rigid' as segmented.

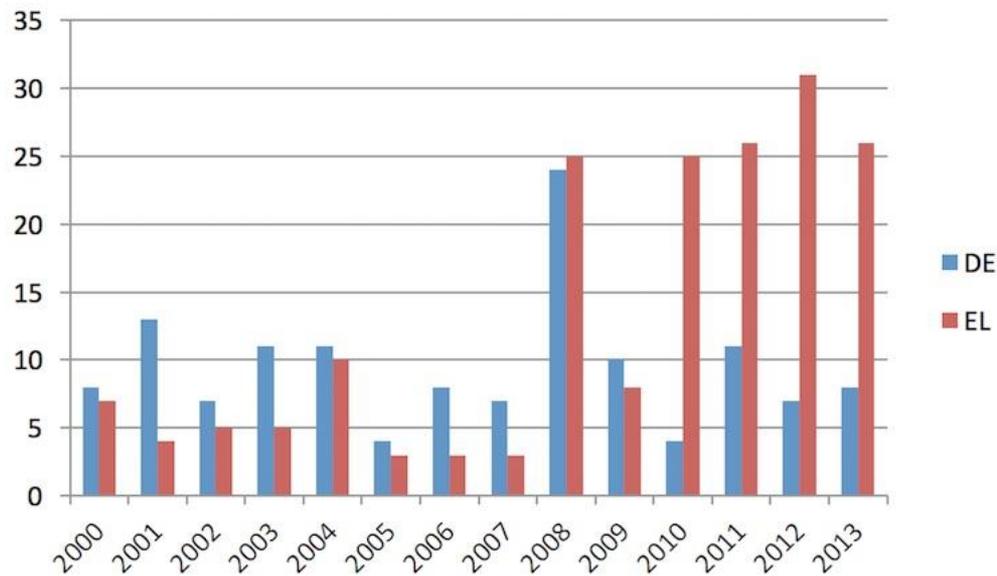
organized interests (cont'd)

- ❖ Labour market segmentation (all figures pre-crisis):
 - ❑ Hyper-protected insiders: approx. 1m workers employed in the union strongholds of the civil service, public utilities, and increasingly less in formerly state-owned banks.
 - ❑ Unprotected outsiders: perhaps 2m persons in construction, tourism and other services, where informal employment is the norm, employers tend to flout regulatory constraints (e.g. dismissal protection, statutory minimum wage, sick or maternity leave - not to speak of the right to join a union).
 - ❑ Under-protected 'mid-siders': about 1.5m workers formally employed in private firms.

Cfr. Jessoula M., Graziano P. & Madama I. (2010) "Selective flexicurity" in segmented labour markets: the case of Italian "mid-siders". Journal of Social Policy 39 (4) 561-583.

labour market reform in Greece vs. Germany

- ❖ “As a useful first pass at the stylised facts we can take the labour market reforms counted by the European Commission (in its Labref database). If, as a first approximation, we simply weight each reform equally. We get the following picture:”



Watt A. (2015) Excessive austerity not a lack of structural reform is holding back investment In Greece. Social Europe blog (posted 1 April 2015).

<http://www.socialeurope.eu/2015/04/excessive-austerity-not-a-lack-of-structural-reform-is-holding-back-investment-in-greece/>

other organized interests

- ❖ Meanwhile, other organized interests went on exacting rents as usual.
- ❖ Product market regulation has historically been very strict, and remains among the strictest in the OECD area.
- ❖ Recent measures have somewhat loosened excessive regulation of product markets. But further liberalization stalled, as business interests and the liberal professions successfully resisted reform.
- ❖ The emphasis on privatization offered enhanced opportunities for (corrupt and/or clientelist) interaction between economic and political actors.

potential gains from structural reforms (2011)

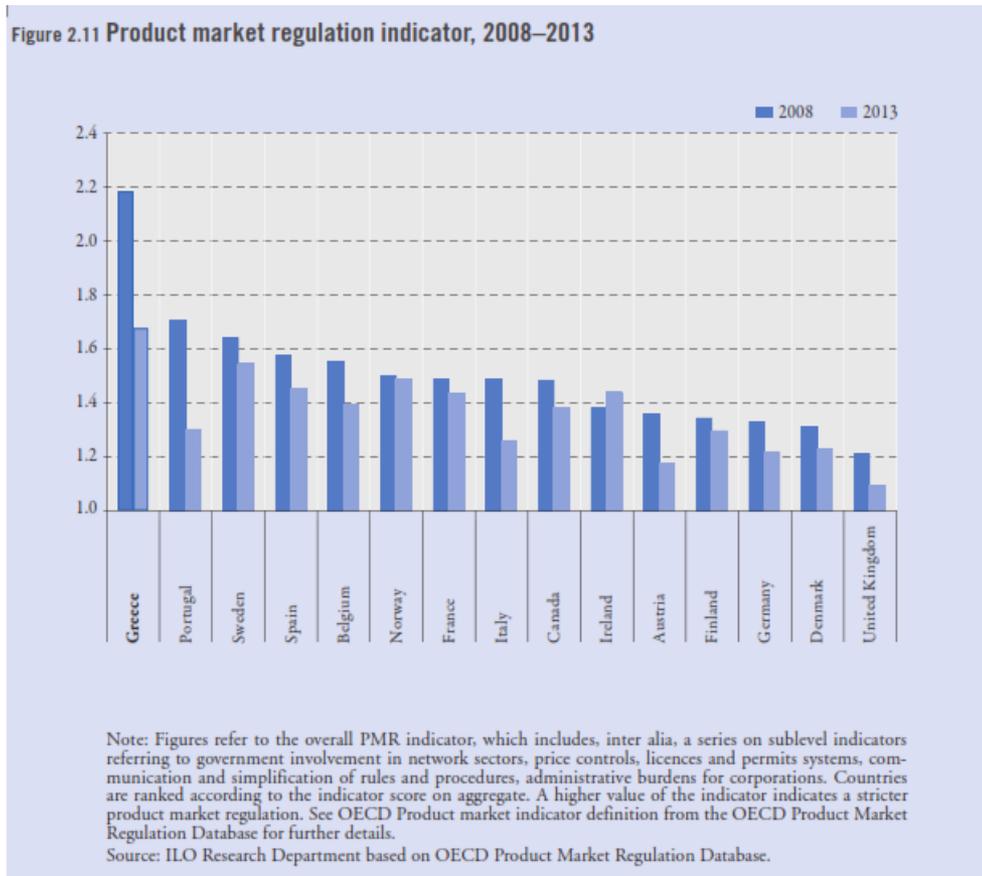
Table 3 Potential impact on real GDP per person of structural policy reforms (%)

	Labour market	Taxation	Product market regulation	Education	R & D incentives	Total
Moving to OECD average						
USA	0.3	1.4	0.0	2.5	0.0	4.2
France	4.5	10.9	2.2	2.1	1.5	21.2
Germany	6.1	9.9	0.0	0.0	0.0	16.0
UK	1.1	0.0	0.0	4.6	0.0	5.7
Greece	6.0	10.1	22.0	5.8	0.0	43.9
Ireland	6.8	0.9	9.7	0.0	0.0	17.4
Italy	0.3	10.8	0.3	5.4	0.2	17.0
Portugal	7.3	0.7	8.5	21.8	1.3	39.6
Spain	3.5	4.6	0.0	6.3	1.4	15.8

OECD estimates.

Cited in Crafts N. (2014) Secular stagnation: US hypochondria, European disease? In C. Teulings and R. Baldwin (eds) Secular Stagnation: Facts, Causes and Cures. A VoxEU eBook. London: CEPR Press.

product market regulation (2008-2013)



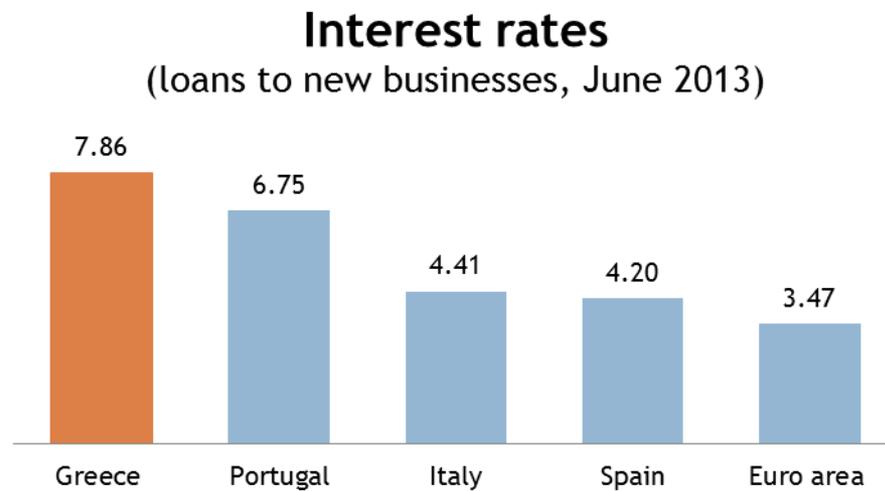
OECD estimates.

Cited in ILO (2014) Productive jobs for Greece. Research Department. International Labour Office: Geneva.

low firm size

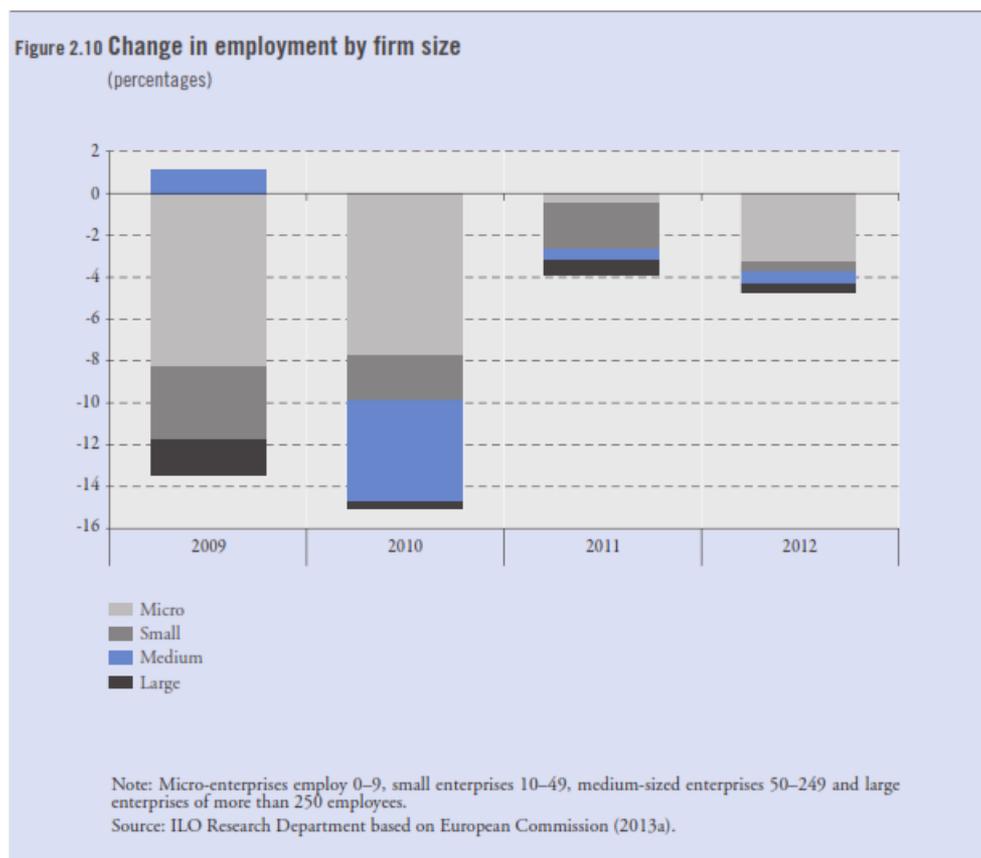
- ❖ Greece features the highest share of micro-enterprises, defined as those enterprises employing 0-9 workers (which includes both very small firms with employees and personal firms of self-employed workers).
- ❖ In 2012, micro-enterprises accounted for:
 - 96.4% of all enterprises
 - 57.6% of the workforce
 - 30% of all value added
- ❖ In theory, even tiny firms can be high-tech and export-oriented (and some really are).
- ❖ In practice, most such firms in Greece are low-tech and catering for the domestic market.
- ❖ Most small and very small firms were unable to turn to exports to make up for the fall in domestic demand, while at the same time facing high capital costs.

high capital costs



Source: ECB

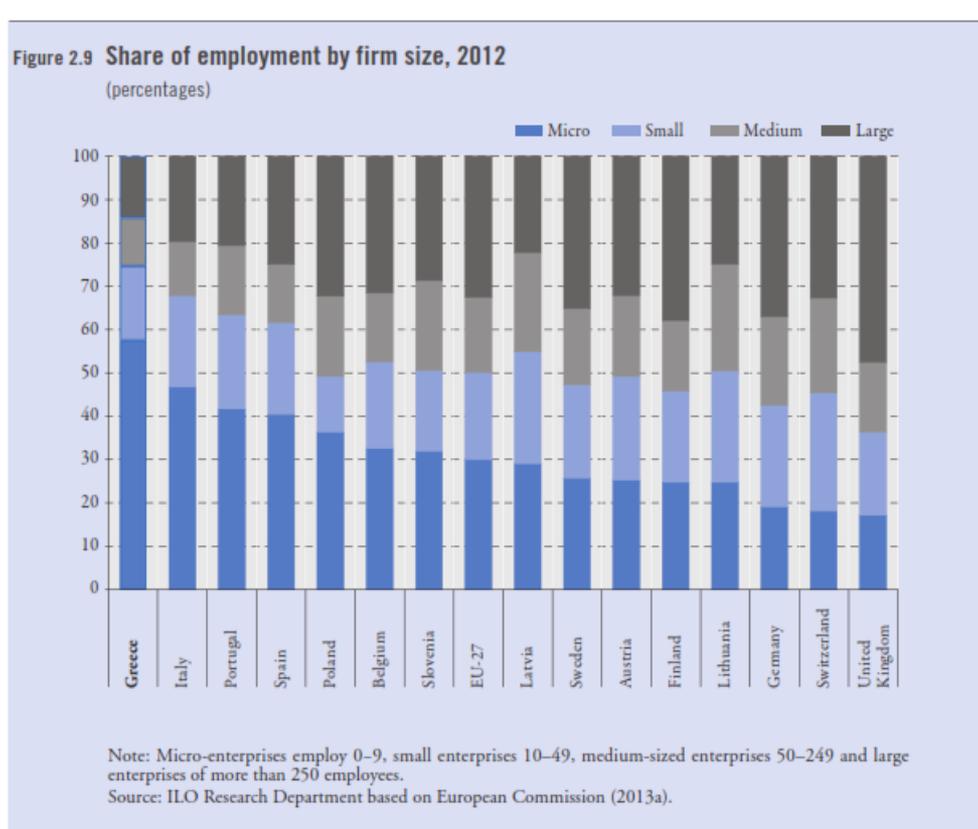
change in employment by firm size



European Commission estimates.

Cited in ILO (2014) Productive jobs for Greece. Research Department. International Labour Office: Geneva.

share of employment by firm size



OECD estimates.

Cited in ILO (2014) Productive jobs for Greece. Research Department. International Labour Office: Geneva.

- context

- facts

- interactions

- key issues

- conclusions

concluding remarks

- ❑ The ‘Greek Programme’ was flawed not just - or not so much - because of the extent and speed of the fiscal consolidation it demanded ...
- ❑ ... but mainly because it misdiagnosed and underestimated the obstacles to a successful adjustment stemming from Greece’s growth model.
- ❑ Even though no longer viable, this model has proved surprisingly resilient: it retains the support of powerful economic and social interests, going far beyond labour unions.
- ❑ But the previous model cannot easily be resuscitated at an era of weak domestic demand. The search for a new growth model goes on, largely unaided by international actors. In the meantime, Greece is stuck in a sort of limbo.

concluding remarks (cont'd)

- ❑ The rise of SYRIZA was greeted with enthusiasm by prominent economists throughout the world, who are opposed to German ordoliberalism and are concerned that excessive austerity stifles a European recovery. In this they are probably right.
- ❑ Krugman, Stiglitz, Piketty and others urged Greeks to vote 'no' at the referendum - even at the cost of GREXIT, if necessary. With all due respect, in that I think they were quite wrong.
- ❑ The Greek recession is not a Keynesian crisis of under-consumption. Nor can it be put right by boosting aggregate demand. That would merely restore Greece's massive trade deficit.
- ❑ Moreover, because the country's traditional growth model is broken beyond repair, GREXIT - and massive devaluation of the national currency - would bring little (if any) economic relief after the immediate collapse in living standards ...
- ❑ ... while it would remain a historical defeat for those hoping to see Greece remain a European democracy.

concluding remarks (cont'd)

- ❑ For similar reasons, the rise of SYRIZA was also greeted with enthusiasm by leftists in Europe (and beyond).
- ❑ It is easy to see why: since the 1970s, when ‘the forward march of labour halted’, leftists have had little cause for celebration.
- ❑ Suddenly, the electoral victory of a party that had polled 4.6% in 2009, plus the spectacle of little Greece standing up to powerful Germany, can be intoxicating ...
- ❑ (... especially if spectators watch from the comfort and safety of their country of origin).
- ❑ With all due respect, I think they too are quite wrong. I find it hard to believe that many western European leftists would be so thrilled if a nationalist-populist coalition like Greece’s were to rule *their* country.

concluding remarks (cont'd)

- ❑ Greece's current cabinet features - among various other interesting personalities - a Defence Minister who would have been ideal for a part in *Vogliamo i colonnelli*, and a Foreign Minister who was a pro-Soviet ideologue in the 1980s, and has successfully recycled himself as an apologist for Vladimir Putin ...
- ❑ ... which may not be entirely irrelevant to the fact that Marine Le Pen and Nigel Farage were so very prominent among those cheering Varoufakis and Tsipras before the July débâcle.
- ❑ Summing up, as I have tried to explain elsewhere:
 - ❑ “To a great extent SYRIZA is a mutant Left: unfamiliar to western eyes (and hence poorly understood by many western observers), but all too terrifyingly familiar to those living in that unhappy corner of the world otherwise known as ‘the Balkans’. To stretch an analogy, the nationalistic left ruling Greece today is in many respects far more akin to the ethno-bolshevism of Slobodan Milošević than to Spain’s Podemos.”

-
- ❑ additional slides

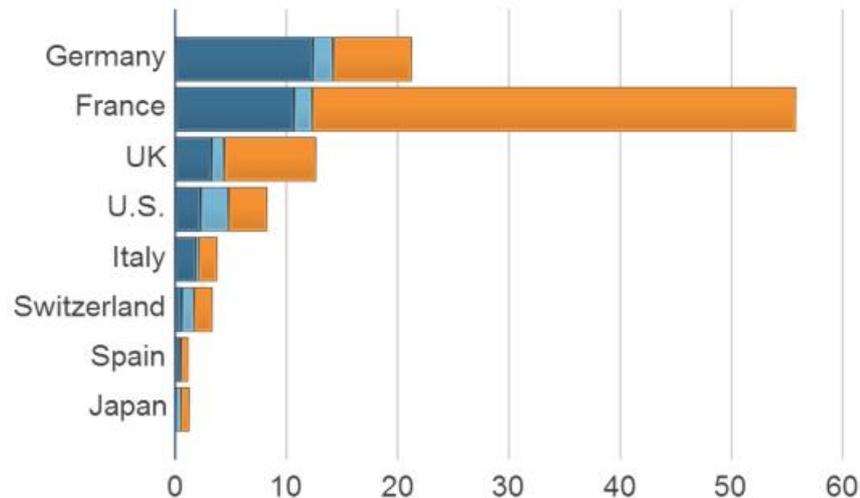
exposure to Greek debt (2011)

Euro zone - bank exposure by country

Bank exposure to Greece by type of debt

\$ billions

Public sector Banks Non-bank private



Select country

Greece

Ireland

Portugal

Spain

Italy

[Link to BIS data](#)

[Package of graphics](#)

[Stress test calculator](#)



Source: Bank for International Settlements - data as at end June 2011