Rent-Seeking in a Time of Austerity: Greece[1]

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Introduction

A widely held view regarding the influence of Greece's membership in EEC/EU (and later in EMU) was that it has exercised a benign influence on the functioning of Greek economy and society by acting as an external constraint enabling Greek governments to invoke the EU as a scapegoat for unpopular, but efficiency-enhancing policies. The onset of the Greek Great Depression[4] put the tombstone on this view, as it revealed that the semblance of "Europeanization" of the institutional and policy infrastructure masked the existence of deeply embedded, clientelistic networks that supported the country's "democratization" of rent-seeking (Moutos and Pechlivanos 2015).

The masking of the underlying reality was stronger during the period 1995–2009, which started with the European Monetary Union (EMU) accession effort. This effort appeared, initially, to tame the ability of the political machine to cater for its constituents, as economic policy focused on EMU accession, and the rhetoric in support of overt populist policies was retracted. Yet somehow this successful bid sowed the seeds of restoration of the previous agenda. Eurozone membership gave the Greek economy low-cost access to international financial markets for the first time. This was a game changer, as this was understood to be a tap on unlimited funding, whose cost would be deferred to future generations. Both government and banks were locked in a growth- on- (foreign) credit- steroids regime, which, as long as foreign credit to both parties was available, allowed Greek governments to continue their clientelistic politics and the private sector (mainly the banks) to postpone the consequences of their increasing foreign indebtedness. As a result, the Greek economy found itself heavily indebted to the rest of the world in the wake of the global financial crisis.

In 2010, Greece lost access to international financial markets, and sought out official assistance. The bailout terms offered to the Greek government by the Troika of lenders (EU, IMF, and ECB) included a heavy dose of (necessary) fiscal consolidation, and a host of other measures – which we may summarily call structural reforms – aimed at assisting the transformation of the Greek economy.

In the rest of this article we examine to what extent the timing and the design of fiscal consolidation and structural reforms, initiated as part of the two Economic Adjustment Programmes (EAPs) for Greece since 2010, have allowed vested interests to largely maintain their privileges by shifting the burden of adjustment to the general population.

Seeing the crisis as an opportunity

"Reform"-minded policy pundits and business leaders understood from the onset of the economic crisis in 2008 that this was an opportunity to push their agenda for structural reforms.[5] Their main argument was that the economic crisis had uncovered and highlighted the economic inefficiencies of the clientilistic politics that have shaped economic policy throughout a great part of the post-dictatorship period in Greece.

The argument went as follows: the sovereign debt crisis severed the country's access to the international financial markets. This meant that the previously overused channel of transferring the costs of inefficient policies to future generations via public indebtedness was shut down. As a result, citizens could start to see the link between the adoption of inefficient "handout" policies

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[4] Maddison's (2010) data indicate that the percentage drop in Greek GDP from 2007 to 2013 is two-and-a-half times larger than the drop in Greek GDP from peak to trough in the 1930s.

[5] See, for example, the Federation of Greek Industries newsletter (SEV 2008).

targeted at particular interest groups and the costs they entailed to be borne by society.

Historically, Greek society has adopted a very relaxed view with respect to the influence exerted by interest groups on public policies. Almost every demand for some sort of "special treatment" to a special group was accommodated. The political economy equilibrium resembled a Ponzi-like scheme, in which new demands were accepted by the already established coalition, as the element of inclusiveness enhanced the political stability of the pact. The economic inefficiency involved, that called into question the long term sustainability of the pact, was suppressed in the public discourse. To understand this, one has to take into account the ideological background against which public discourse on economic policy developed in Greece. Fuelled by ancestral feelings of economic inequality and social stratification (i.e., deep-rooted perceptions against the illegitimacy of the existing social and economic order), requests for "special treatment" were understood as a fair payback for previous grievances. Arguments against the adoption of "handout" policies to particular groups due to the imposition of costs to society were ostracized from the public discourse with the smear that were turning parts of society against each other, and hence were tearing away at the social fabric.[6]

Hence, the main question was whether fiscal consolidation and structural reforms are complementary instruments or not. Would citizens see themselves as part of the general populace that stands to benefit from the enhanced efficiency of the reformed economy, or would they instead relate separately to their group's endangered sweet-deal? Which is then the optimal time structure of the reforms to minimize resistance to reform by creating supporting coalitions for the policies needed?

Obviously, if a reform program is to be implemented one has to decide on its pace. Should it be frontloaded to take advantage of the initial window of opportunity given to the reforms by the general populace? If a more gradual approach is to be adopted, it has to be decided which reforms should be given precedence so that an appropriate sequencing of reforms creates coalitions for further reforms (Dewatripont and Roland 1992; 1995).

[6] This argument was codified in the public discourse as a defense against "social automation". Hence, for example, a private sector employee should not be complaining about the perks enjoyed by certain public sector employees (at taxpayers' expense), but should fight for an equivalent deal instead.

It is interesting to note that, nominally at least, the Greek population seemed to be in favor of "reform" when the crisis erupted. This attitude was shaped in no small measure from the media, which started exposing gross cases of tax evasion and public sector corruption, as well as cases of under-worked and over-paid public sector employees. As a result, many Greeks started feeling that an externally imposed, and thus more likely to be fair, austerity and reform package could set the country on a virtuous path and punish (at least some) of those responsible for the crisis (EEAG 2011).[7] Needless to say, this support retreated soon after the first "pain" from the measures was felt.

The uneven pace of reforms

By design or fiat, a dual approach was employed throughout the lifespan of the two Economic Adjustment Programmes (EAPs) for Greece since 2010. Mainly by necessity, fiscal consolidation was frontloaded. Structural reforms, by contrast, were designed to be implemented at a gradual pace. Their actual implementation, if at all, was much slower.

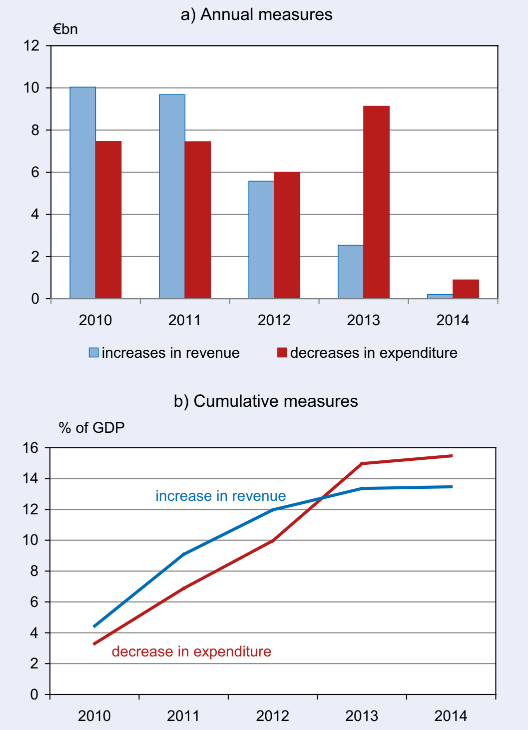
The first major pillar of EAPs was fiscal consolidation. Figures 1a and 1b portray the discretionary fiscal effort (DFE) undertaken by the Greek governments regarding current expenditure and revenue since 2010. The DFE – as calculated by the European Commission – provides an alternative measure of the discretionary policy actions to the traditional measure of the change in the cyclically adjusted budget balance, which suffers from well-known robustness and endogeneity problems (European Commission 2013). The two figures indicate that during the first two years (2010 and 2011) budget consolidation relied more on revenue increases (57 percent of the total DFE) than on expenditure decreases, whereas during the latter three years the modality of fiscal consolidation was reversed, with expenditure decreases accounting for 66 percent of total DFE. Clearly, the DFE was frontloaded, with 58.7 percent of it taking place in the first two years. The average DFE per year was 5.8 percent of GDP.

The heavy dose of austerity, in tandem with the credit squeeze and the sharp rise in real interest rates, took their toll on macroeconomic outcomes. GDP in 2014 was 25.7 percent lower relative to its peak in 2007, whereas final consumption expenditure dropped by 23.6 percent

[7] See EEAG (2011) for more details.

Figure 1

Discretionary fiscal measures



Source: AMECO; authors' calculations.

between its peak in 2008 and 2014. The drop in investment was enormous, as its level in 2014 was only one-third of its peak level in 2007 (a drop of 64.7 percent). In tandem with these developments the unemployment rate peaked at 27.5 percent in 2013 from a low of 7.8 percent in 2008 and declined to 26.5 percent in 2014. It is worth noting that the youth unemployment rate (of under 25 year-olds) soared from 21.9 percent in 2008, to 58.3 percent in 2013, and to 52.4 percent in 2014.

Ultimately, however, the austerity policies did the trick and addressed the fiscal and external imbalances facing the country.[8] The consequence of the austerity medicine was nevertheless a general populace backlash against the first EAP, which led to political turmoil in 2011-12 and uncertainty about Greece's place in the euro area, both of which emboldened vested interests opposed to reforms (IMF 2014).

The second basic pillar of the EAPs for Greece was structural reforms, which mainly comprised fiscal structural reforms (including social security), labor and product market liberalization and privatizations. Priority was given to those reforms with a clear positive fiscal effect, such as the streamlining of the compensation scheme of public sector employees, and of the pensions and social benefits structure. Reforms affecting the general population were also prioritized over those targeting specific groups. This approach was underpinned by the idea that these reforms could produce a more pronounced outcome, or even set the pace for the rest. On the other hand, such an approach helped special interest (and better organized) groups to retrench themselves to avert the reforms or minimize their negative impact.

Fiscal structural reforms

The urgent need to eliminate the primary budget deficit was the driving force behind the swift implementation of reforms related to public sector employees' compensation and government spending on pensions. For instance, the general compensation scheme for public employees was the first to be reformed and serious efforts were made to abolish its fractured nature.[9] The reform of compensation schemes for special categories of civil servants, by contrast, was delayed at least a year, and maintained its opaqueness regarding various allowances intact, which later on down the road of the reform path were used to partially reverse the intended reform goals, as court orders pronounced some of these allowances tax-free.[10]

The same urgency was not observed with other reforms such as the broadening of the tax base. Delays were observed in transferring experienced staff from other public bodies into tax administration and completing new recruitments. For example, the large taxpayers' unit has many fewer staff than intended, and their work has been diverted to transfer pricing cases, rather than generally targeting large taxpayers. Tax authorities were not insulated from political interference, as was demonstrated in 2014 by the decision of Greece's Secretary General for Public Revenue to resign from his job due to intense political pressure not to go after the well-connected, just 17 months into what should have been a five-year term.

[8] Indeed, both the current account and the primary budget deficits were over ten percent of GDP when the adjustment started, and by 2014 both registered a small (less than one percent) surplus.

[9] A major step in this direction was the establishment of the Single Payment Authority for all public-sector employees. Unfortunately, even to this date, some government organizations (e.g. the Greek Parliament) have been allowed to remain outside its purview and control.

[10] It remains a mystery why the government did not try to generate conflicting interests between the general and special classes of civil servants by setting a certain "rebate" for the general public servants, tied to the savings brought by the reform on the special compensation schemes, applicable whenever the reforms for the special classes of civil servants get implemented.

Labor and product market liberalization

Labor market regulation has also been a contentious field in which significant reforms were adopted earlier in the program in the wage bargaining system with the abolition of the automatic expansion of sectoral agreements and the adoption of firm-level agreements. Nonetheless, according to the IMF (2014) excessive restrictions remain that raise the cost of doing business and inhibit the establishment or expansion of larger-sized firms. For example, disputed collective dismissals are de facto not allowed. They used to require the approval of the Minister of Labour (and now the Ministry's Secretary General), but no such approval has been granted since 1982, forcing companies to offer very high voluntary severance packages or resort to bankruptcy. Lockouts are still prohibited, even as a defensive tool for employers during negotiations.

However, even although employment protection legislation (EPL) in Greece did not proceed as far as the Troika would like, it became significantly lighter than before. Indeed, OECD's EPRC_V3 indicator (i.e. the weighted sum of sub-indicators concerning the regulations for individual dismissals (weight of 5/7) and additional provisions for collective dismissals (weight of 2/7)) declined from 2.85 in 2008 to 2.41 in 2013 – the corresponding numbers for the EU15 average were 2.64 in 2008 and 2.52 in 2013 (OECD 2014). Thus, whereas Greece had above-EU15 average EPL in 2008 according to this indicator (five countries had EPRC_V3 higher than Greece), by 2013 its EPRC_V3 indicator was below the EU15 average (nine countries had EPRC_V3 higher than Greece). We note that among the Southern European countries, members of the EU15 (Greece, Italy, Portugal, Spain, or SE4), Greece's EPRC_V3 indicator was lower than that of both Italy and Portugal in both 2008 and 2013.

Many of the enacted policy changes were in accordance with the stated objectives of the main employer organizations since the 1990s, i.e. Federation of Greek Industries (SEV), the General Confederation of Professionals, Craftsmen and Merchants (GSEVEE) and the National Confederation of Greek Trade (ESEE). However, it should be stated that there were significant differences among these organizations – due to differences in size and dependence on foreign markets – with SEV showing the biggest interest in dismantling pieces of EPL.

In summary, with the exception of SEV's support for EPL reform, no major political party or social partner (either before or after the crisis) had publicly expressed an interest in weakening EPL. The standard political-economy explanation for this state of affairs is that EPL benefits a well-organized (through the device of trade unions) part of the population, thus making the implementation of any reform difficult. An alternative explanation is that although the main beneficiaries of EPL are trade union members in industries facing little international competition, there is a "lighthouse effect" on employment and pay conditions in the rest of the economy, since EPL increases the bargaining power of labor vis-à-vis oligopolistic firms, thus providing a wider base for political support. (The case that some (large) incumbent firms may perceive strict EPL as a way to stifle potential competition from start-ups should not be discounted either.)

In a similar vein, Greek governments have shown reluctance to follow OECD recommendations, which could foster product market competition, increase competition and lower prices. Some measures that were implemented early on in the liberalization of road freight transportation and taxi services met with significant resistance and possibly derailed further measures.[11] Some of the recommendations that the OECD estimated would yield significant benefits to consumers are being implemented only partially, such as the elimination of advertising charges, the removal of excessive restrictions on milk, the liberalization of prices and distribution channels for over-the-counter drugs and food *supplements*, and the liberalization of Sunday trading. Other actions that have been fiercely restricted by the authorities include opening up the mediation profession (which will help reduce the high inflow of new cases in courts), eliminating remaining excessive restrictions relating to lawyers, eliminating excessive reserved activities for engineers, and adopting secondary legislation on a number of important professions and activities (including electricians, actuaries, chartered valuers, and pharmacists – see below). As a result, and despite the pressure exercised by the Troika, Greece's overall index of product market regulation, as measured by the OECD (2015), stood at 1.74 in 2013, which was higher (i.e. stricter) than any other euro area country.

The reform in the pharmacy profession is a particular good example of the muddle- through process, with stalls and reversals present in many sectoral reforms, where resistance from vested interests was ferocious.

[11] The interesting element in the above mentioned reforms was that they were taking place concurrently with changes in the tax code that allowed regulatory takings to be compensated via temporary grandfathering clauses in the tax code. That was an opportunity that could not be exploited subsequently in other reforms.

The intended goal of the reform was to abolish regulations in the pharmacy profession such as covering limits on the number of pharmacies, opening-hours restrictions and minimum profit margins. Although most of the measures were enacted by law, subsequent ministerial decrees relegated final decisions to local authorities, more easily susceptible to vested interests pressure. At the end of the day changes were side-tracked. For example, stricter opening-hours restrictions were re-imposed on a local scale, while those pharmacists operating within the "nationally" allowed time schedule were persecuted.

Why were fiscal targets (mostly) met, but structural reforms lagged?

Wide-ranging reform initiatives like those needed in the Greek case, face two types of political constraints. The first type is ex-ante political constraints that can block decision-making and prevent reforms from being accepted. The second type is ex-post political constraints that are related to backlash and policy reversal in case of undesirable outcomes following their implementation (Roland 1994).

The political economy argument in favor of gradualism is that an appropriate sequencing of reforms can provide demonstrated successes to build upon, thus creating constituencies for further reforms (Dewatripont and Roland 1995). A gradualist approach was indeed adopted in Greece as of 2010, but the sequencing of reforms was exactly opposite to that which would gradually increase support for further reforms.

Since Greek governments knew that it would be easy for the Troika to assess whether the quantitative fiscal targets were met, fiscal consolidation proceeded at a fast pace, and the fiscal targets regarding the budget deficit were (mostly) achieved. However, the initial heavy reliance on tax increases rather than expenditure cuts hurt all tax-paying citizens, but maintained the privileges of the traditional non-tax-paying groups and special groups of public-sector employees whose wages suffered smaller declines.

On the other hand, structural reforms were designed to be implemented at a gradual pace. Their actual implementation, if at all, was much slower. Unlike fiscal targets, many structural reforms were legislated, but few were implemented as important follow-up ministerial "clarifications" regarding their implementation were either not issued or significantly weakened their force to break the power of privileged stakeholders. The large drops in real incomes and the steep rise in unemployment rates suffered in the early years of heavy fiscal adjustment – before the beneficial effects of the limited set of actually implemented structural reforms could be observed –created huge constituencies against further implementation.

A key issue in this respect was the existence of complementarities between labor and product market liberalization. As argued by Blanchard and Giavazzi (2003), deregulation in product markets, by reducing rents, increases acceptance of more competitive wage setting in the labor market. Clearly, by setting different time schedules for labor and product market reforms, the EAPs missed this opportunity.

The common cry of the suffering unemployed and of those that managed to maintain their privileges was that the EAPs had failed and that the reforms prescribed in them should be revoked. The popular backlash made Greek authorities unwilling to proceed with further reforms (or implement those already legislated). It is thus not surprising that less than half of the planned IMF reviews were completed, and that only one has been completed since mid-2013, due to the failure to implement the agreed reforms.

Concluding remarks

With the benefit of hindsight it is clear that if one wanted to derail the effort to eradicate the web of interlocking interests that brought Greece to the brink of the crisis that became visible six years ago (and is still gathering strength), it could do no better than follow the structure and sequence of policy decisions taken since 2010.

One way to understand what happened is to note that the crisis brought to the fore what has been a perennial characteristic of Greek society, namely the lack of social trust. Political scientists and economists have noted that Greek society is characterized by what Banfield (1958) called *amoral familism,*[12] i.e. the fact that individuals rarely extend their trust beyond the family nucleus and a restricted number of friends and acquaintances (see Siotis 2011 for an interesting analysis applied to the Greek context). The existence of a fragmented and clientelistic "social welfare system" has helped to cement this

[12] Banfield used this expression to describe southern Italy.

attitude. This also explains why the young – especially the educated ones – have not exercised any political pressure to stop the excessive budget subsidies received by many pensioners, i.e. because it is their parents or grandparents that receive these subsidies, part of which, in turn, are transferred to them. From the perspective of economic efficiency (and social justice as well), it would have been better if the excessive budget subsidies paid to many pensioners had been used to allow for a reduction in the labor tax wedge and a rise in employment, thus increasing support for further reforms.

Instead of sequencing the reforms to build coalitions supporting further reforms, the opposite was achieved. Reforms horizontally affecting the general populace were given priority, leaving targeted reforms affecting special groups for later on. Nonetheless, the greater than predicted recession, with the social pain it inflicted, brought about reform fatigue among the general population. Special interest groups rode along this popular backlash and stalled the implementation, or even revoked already legislated measures. It is a pity that the suffering unemployed or bankrupt businessmen inadvertently became the shield that allowed powerful interest groups to maintain their privileges.

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