From riches to rugs or what went wrong in Greece

By

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Abstract

The economic and social progress Greece achieved in the early post war decades decelerated after 1974 because all institutions sustaining the efficient operation of democracy and free markets were deliberately and gravely eroded. Under the impetus of hard core socialists provisions introduced in the 1975 constitution, economic policies extended further in the direction of unfettered statism, thus destroying the international competitiveness of the Greek economy. Some researchers have attributed the economic decline of Greece to its entry into the EU. I look into these allegations and find that they have little or no basis on the available evidence.

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Introduction

The post war performance of Greece has all the characteristics of a period of remarkable progress, which was followed by a period of equally remarkable decline. It is a unique case which ought to be taught to students, ordinary citizens, politicians and experts in the expectation that they may appreciate how: (a) people can be misled by superficial and selfish leaders to consent to reforms and policies that kneel both democracy and economy, (b) the political parties in power undermine democracy, by discrediting gradually the institutions that safeguard the operation of free markets, and (c) policies, economic and others, which appear to be successful in the short run, in the long run become catastrophic if they are not revised appropriately in time.

In the sequel I do three things. In the first section, *I* span economic growth in the post war period and identify the main factors that determined the phase of expansion before and the phase of contraction after 1974.[1] The presentation in this section is purely factual in the sense that, with the exception of a few comments regarding certain technical details about the data used, I abstain from interpretations as to why the economic forces that promoted economic growth endogenously before 1974 reversed afterwards, leading eventually to the present gruesome situation. Our view about what went wrong and Greece experienced this spectacular reversal is explained in the second section. More specifically, initially I turn our attention to the changes that took place in the political and economic institutions and find that what happened was exactly what one would have expected from the relevant literature. After 1974 the economic and social progress decelerated at the beginning and gradually led to the crisis of today, because all institutions sustaining the efficient operation of democracy and free markets were deliberately and gravely eroded. Next, in the same section, I assess the economic policies that were adopted and arrive at the following reinforcing finding. In view of the advancing globalization and the accession of Greece to full membership in the European Union (EU) in 1981, and to Eurozone in 2002, the closed economy macroeconomic and structural policies of the past ought to have been reoriented towards those of an open and competitive economy. But under the impetus of the socialist provisions introduced for the first time in the 1975 constitution, economic policies in general extended further in the direction of unfettered statism, thus destroying the international competitiveness of the Greek economy. Unlike our assessments, some researchers have attributed the economic decline of Greece to its entry into the EU and the loss of monetary policy independence due to the adoption of a common currency. For this reason, in the last part of the second section, I look into these alle-

[1] This is the year democracy was restored in Greece after seven years of military rule.

gations and find that all responsibility for what happened rests with the Greek governments, politicians and managers in the state sector of the economy. Finally, in the third section, I close with a summary of our findings and some comments regarding their usefulness as guiding principles of governance in the context of contemporary democracy.

1. The economy: 1950-2010

Economists monitor the progress of economic phenomena by using appropriate indexes. For example, a well-known index is the real Gross Domestic Product (GDP), which measures the quantity of goods and services produced in a year and is defined as the sum of their values expressed in the prices of a base year.[2] Another index detects the situation that prevails in the labour market and takes the form of a percentage of all workers in the labour force who wish to work and cannot find a job. This measures the level of unemployment and it is very important, because it has to do with a very unpleasant social phenomenon, especially when it refers to citizens in young or late years of their working ages. Yet another index measures the changes in the general level of prices, one version of which is the Consumer Price Index (CPI). From these examples it follows that gauging the performance and the problems of an economy depends to a large extent on the available data. Necessarily therefore in order to highlight the trends that prevailed in the Greek economy in the post war period, I shall confine ourselves to a sample of standard indexes from domestic and international sources, which are available on request by the authors.

1.1 Economic growth and its sources

Figure 1 presents the average percentage changes of GDP in Greece and the corresponding periods during which they were observed, beginning with 1954. Looking from left to right one cannot fail to observe that the process of economic growth registered five phases. In the first phase, which occurred in the period before 1974, the growth rate was 6.9%. This phase was followed by a second one, which lasted from 1974 until 1981, and exhibited a growth rate of around 3.5%. In the third phase, i.e. that of next phase of 1981-1994, the growth rate was less than 1%. Then, in the fourth phase, which lasted until 2008, the growth rate exhibited considerable variability around a trend of 2.4%; and, lastly, quite recently the economy entered a fifth phase with negative growth rates, which during the period

[2] Adding to Gross Domestic Product (GDP) net transfers of income from and to third countries yields Gross National Product (GNP). Subtracting from the latter indirect taxes gives Gross National Income (GNI). These indices are used depending on the problem under consideration. If, for example, the problem has to do with the domestic economic activity, appropriate is the index of GDP. On the other hand, if the problem of interest has to do with the external relations of a country, then appropriate is the index of GNP.

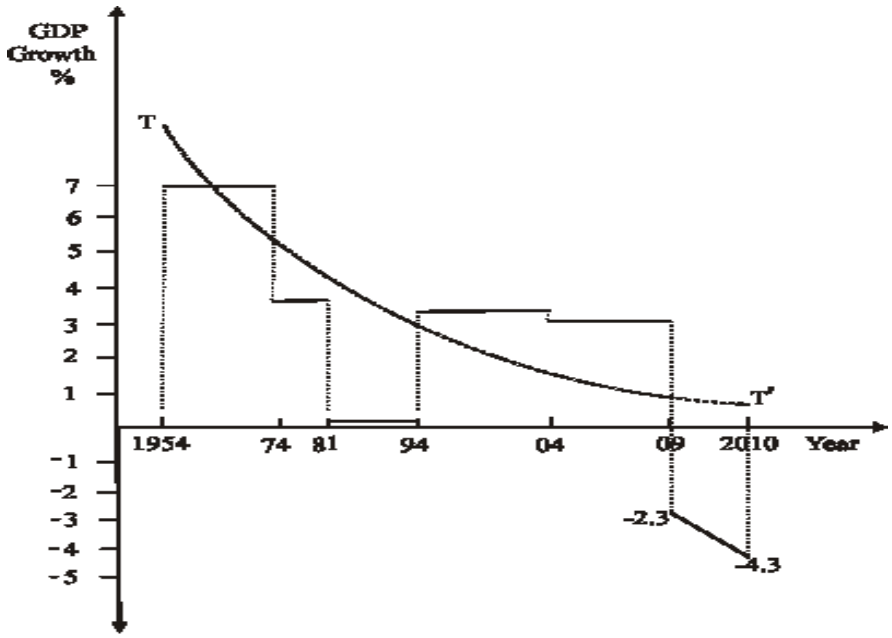


Figure 1

2009-2011 are likely to average -3.2%. For the reasons that I shall explain later on, it should be noted that the growth rates over the period 1954-2010 followed a negative trend. In Figure 1 this is indicated by the downward slope of the dotted line, which corresponds to the following equation:

$$\%\Delta\text{GDP} = 0.126\text{T} - 0.0006\text{T}^2$$
$$(3.63) \qquad (-3.57)$$
$$\bar{\text{R}}^2 = 0.23 \quad \text{D.W} = 2.0 \quad \text{RHO} = 0.185$$

where the variables % ΔGDP and T represent respectively the percentage change of GDP and the year, $\bar{\text{R}}^2$ is the adjusted correlation coefficient, D.W stands for the Durbin-Watson statistic, RHO is the autocorrelation coefficient, and the figures underneath the parameter estimates give the values of the t-statistic.

Now turning to the sources of economic growth, these coincide with the changes in the productivities of human and physical capital, as well as the productivity contributed by numerous indistinguishable factors. Figure 2 depicts the time patterns of the productivity indexes for human and physical capital and the index of total factor productivity since 1960. From this it turns out that:

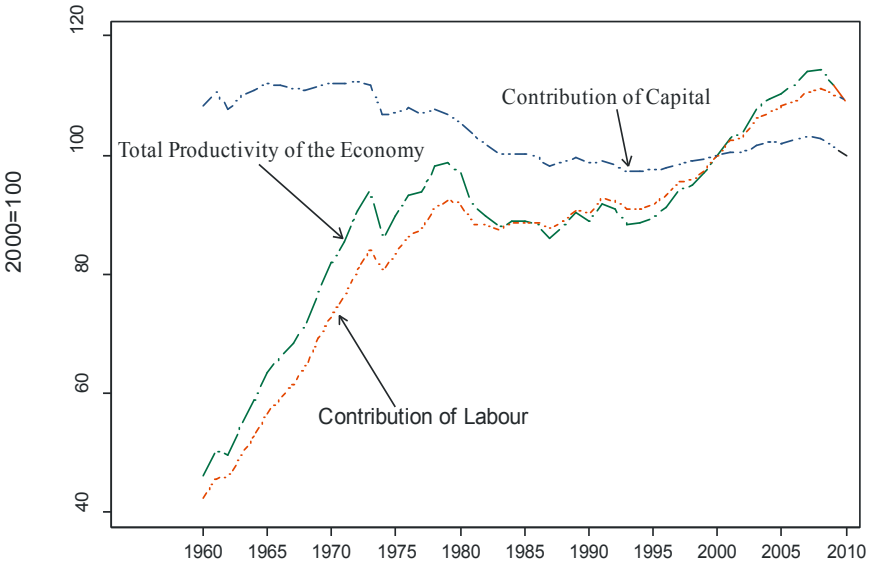


Figure 2

- For the whole period 1960-2010, the trend in the productivity of physical capital was slightly decreasing.
- Over the period 1960-1981, the productivity of physical capital run above its long term trend, in the period 1982-2004 it moved below it, and since then it passed again above it slightly, but in recent years it has been declining.
- With the exception of the period 1974-1993, when the productivity of human capital fluctuated around a horizontal trend, in the periods 1960-1973 and 1994-2008 its trend was upward, but in the former period it was comparatively steeper.

These observations, in conjunction with ones above from Figure 1, help us understand to a significant extent the sources from which economic growth emanated in post war Greece. Prior to 1974, the high growth rates were achieved because of strong contributions from accelerating productivities of both human and physical capital. In the period 1974-1981, the rate of increase in the productivity of these two productive factors decelerated, with the consequence that the pace of economic growth slowed down to half the average rate of the previous period. Over the years 1981-1994 economic growth collapsed because the decline in the productivity of physical capital was just counterbalanced by the changes in the productivity from all other sources. From 1994 to 2008 the growth of labour productivity accelerated significantly, whereas that of physical capital increased only moderately, thus raising economic growth to the average 1974-1981

rate. Lastly, the decline in all productivity indices since 2008 explains the progression into the territory of negative growth rates.

With respect to the data on which the above evidence is based, three comments are in order. The first has to do with the growth rates. Our data come primarily from the database of the European Statistical Office (AMECO). To extend the GDP series back to 1954, I used data from various issues of the National Income Accounts published by the National Statistical Service of Greece. As the data from the former source were available at constant 2000 prices in Euros, whereas those from the latter were reported in dollars and in constant prices of various base years, to unify them I used consistent statistical methods. The second comment relates to the occasional revisions of National Income Accounts. One such revision took place, for example, in 1988. Its intended purpose was to adapt the Greek to the European System of Accounts. At that time the Greek authorities increased GDP 22% on the reason that they had managed to improve the measurement of economic activity in the dormant or latent part of the economy. But, according to Bosworth, Kollintzas (2001, 184-186), the backward projection of this increase in GDP introduced certain uncertainties as to the precision of the calculations.[3] Finally, the third comment is that using actual wages as an alternative approach to measuring the rise in living standards is untenable in Greece, because the number of self-employed is very high as a percentage of all workers.

On this basis of the above I adopt the view that Figures 1 and 2 describe with reasonable accuracy the process of economic growth, as well as the main sources that contribute to it, during the post war period.

1.2 Investment and investable resources

After the Marshall Plan ended in 1952, foreign aid to Greece did not stop. Financial aid continued to flow from various sources, although on a relatively smaller scale. So the burden of financing investment shifted over to sources such as domestic savings, capital transfers from abroad for the purchase of real estate, and borrowing from international markets. Thus, starting from the realization that the resources which become available to

[3] National income statistics are revised frequently and the revisions are not accepted without reservations among specialists. In Greece, for example, Tsoris (1975) expressed reservations regarding the revisions of national income accounts in 1973. But, as a rule, reservations do not exceed the limits of a technical discussion among economists, statisticians and other specialists, and in any case they do not give rise to suspicions and comments about expedient distortions. Unfortunately, in Greece the revisions, for example, of 2000 and 2007 became subject of strenuous contentions among the political parties. As a result experts in Greece and abroad started to question the trustworthiness of the revisions. However, the Hellenic Statistical Service more recently became completely independent from the government, and hence it is our hope that the demeaning references to the so-called "Greek Statistics" will be forgotten soon.

an economy define the limits within which investments may be undertaken for the purpose of accelerating economic growth, there arises the question: Did the supply of investable funds meet the demand for investment and, if so, to what extent? To answer it, I shall examine the developments that took place in the fields of investment, saving, foreign aid and borrowing.

Domestic and foreign direct investment

In 1952 the country's infrastructure had been rebuilt from the ruins and the savages of the Second Wold War and the civil war that followed. Also, the productive capacity in agriculture and industry had exceeded prewar levels. These results were achieved mainly due to investments financed by foreign aid, initially from UNRRA and a little later from the USA under the Truman Doctrine and the Marshall Plan.[4] Such was the contribution of these programs that, when several years after they ended Adelman, Chenery (1966) investigated empirically their influence to the reconstruction of Greece, they concluded that this aid has laid the foundations for the spectacular growth in the period 1951-1961. Hence, even though most evidence shows that Greece did not take as much advantage of foreign aid as other Western European countries, the path for its take-off in economic development begun with significant investments financed from the above sources. Expressed in a different way, Greece's economic take-off would have been much delayed without these investments, because GDP declined in the 1940s so much that it did not leave room for substantial savings.

Figure 3 depicts the time patterns of gross fixed investment and some of its main components as percentages of GDP at constant 2000 prices. On reflection, and even without statistical analysis, it turns out that:

- From 1954 until the early years of the 1970s, total fixed investment followed a strong upward trend. Then, it vacillated around a permanent downward trend, declining from 33.7% in 1973 to 16.8% in 2010. In particular, until the mid-1990's it remained steadily below the long-term trend. Then, it started moving upwards, and after it crossed the trend in 2000, it peaked in the middle of last decade. Since then gross fixed investment continued to decline at rates that predicated its fall even below the long term downward trend.
- Business fixed investment, i.e. investments for productive purposes, except for a brief but significant slowdown in the period between the two oil crises in the 1970s, followed an uneven upward trend. More specifically, while in the period 1953-1973 it grew at an average rate of 17.5%, in the period 1978-2010 its pace of increase

[4] According to Milward (1984, 53), the assistance in various forms that Greece received from the Marshal Plan in the period July 1945-June 1947 was bigger even than that the United Kingdom received from the same source.

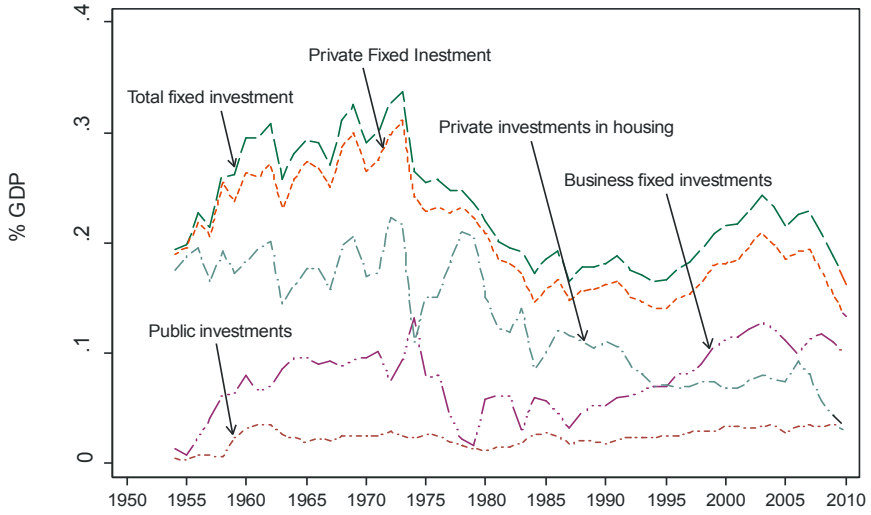


Figure 3

slowed down to 7%.

- Since 1979 private and business fixed investment moved inversely, because business investment did not increase robustly enough to counterbalance the strong downward trend in housing investment.
- Fixed investment by the government remained stable with modest variability around an average annual percentage rate of 2.4%.
- The above remarks imply that economic growth after 1974 was driven primarily by increased consumption, with a simultaneous shift towards perishables and away from housing services, and only secondary by increased business investment. As for government fixed investment, all indications are that its role was complementary.[5]

I am ready now to turn to Foreign Direct Investment (FDI), which constitutes a source of economic growth, and indeed a very important one, because it serves as a channel through which new products and production techniques are transferred from the countries of origin to the countries of destination of such investments.

Figure 4 illustrates the inflows and outflows of FDI using data from UNCTAD for the period 1970-2009 and from domestic sources for the period 1954-1970, as percentage of Gross National Product (GNP).[6] From

[5] At the beginning of the 1990s the journal *Greek Economic Review* carried an interesting discussion regarding the issue of whether the quick expansion of the public sector had "suppressed" or "damaged" that of the private sector. On the one side of issue were Bacon, Karayiannis-Bacon (1980, 1981), whereas on the other were Hadjimatheou, Skouras (1980). Based on the time pattern of investment in Figure 3 we can surmise that public investments were complementary rather than antagonistic to those of the private sector.

[6] The data from these two sources are reported in US Dollars of current nominal value. From these sources we chose the series which are exhibited in Figure 4 after two ad-

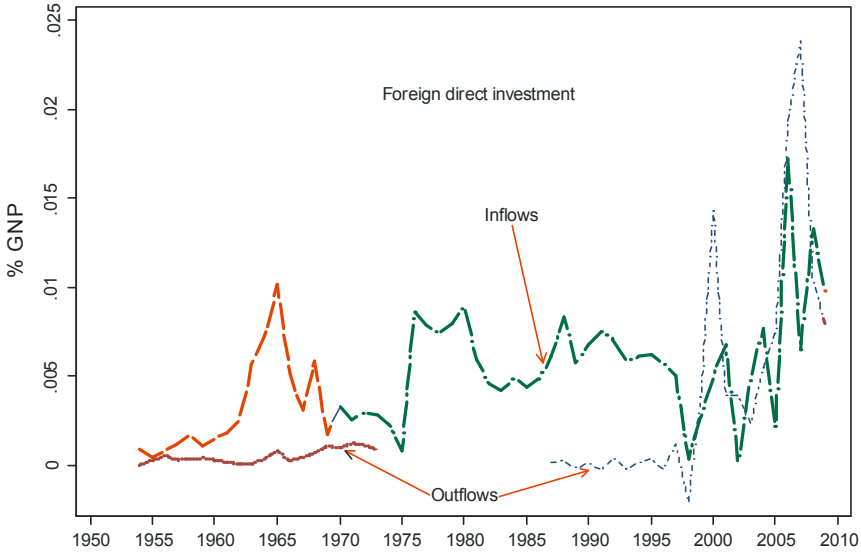


Figure 4

these it follows that the annual FDI inflows during the period 1954-2009 averaged 5 ‰ of the GNP. But, starting from the last years of the 1990s even these insignificant inflows were largely offset by outflows, mainly to neighbouring Balkan countries. Because of this reason, the data show that the last fifteen years, the average annual net inflow of FDI should not have exceeded 1.5 ‰ of GNP.

Saving

To shed light on the sources and time patterns of saving, I combined data from: a) the AMECO database, b) various issues of the *Statistical Yearbook of Public Finance*, published by the National Statistical Service of Greece, and c) historical statistics compiled and published occasionally by the Bank of Greece.[7] The time series I obtained are depicted in Figure 5 and on closer look we observe the following:

justments. First, using the index of Purchasing Power Parity (PPP), we converted the dollars into euros, and then, second, we converted the series that resulted to constant prices of 2000 with the help of the implicit price deflator of total gross investment.

[7] More recently Hondroyiannis (2004) did another computation of private savings. Although the time actual series is not reported in this publication, from the diagram presented by the author uses it follows that his series is very close to the one depicted in Figure 5.

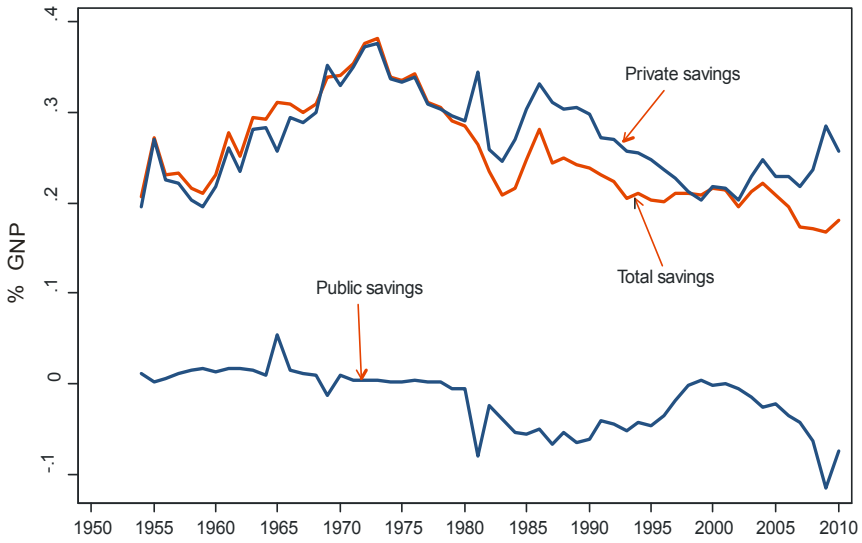


Figure 5

- During the first two decades, which coincide with the period of fast economic growth, saving increased gradually from about 20.7% of GNP in 1954 to 38.2% in 1973. Since then saving has followed a downward trend, which in 2010 stood at 18.1%.
- Throughout the period under consideration, almost all saving was generated from private sources. In particular, of the total savings of 20.7% of GNP in 1954, 19.6% was contributed by the private sector and only the remaining 1.1% came from the public sector. In 1973, when saving was 38.2% of GNP, 37.8% from private and public sources came 37.8% and 0.4%, respectively. Finally, in 2010 when saving was 18.1% of GNP, the corresponding shares were 25.7% for the private and -7.5% for the public sector.
- From 1954 to 1978, state budgets left slight surpluses averaging 1.1% of GNP per annum. However, since then, state budgets have experienced annual deficits of the order of 3.4% of GNP.[8]
- While starting from 1981 public budgets incurred very heavy defi-

[8] According to Alogoskoufis (1995, 158, 159), from 1958 until 1992, the budget of the central government run deficits, which in 1989 approached 18% of GDP, whereas the public debt had risen to 120% of GDP already from 1992. These data are in sharp contrast to those reported by Bosworth, Kollintzas (2001), which come from the publication of the National Statistical Service of Greece, *Macroeconomic Series Based on ESA95, 1960-1999*, as well to those from AMECO on which Figure 5 is based.

cits, in the critical period 1998-2002, when the entry of the country into the Eurozone was at stake, the deficit nearly disappeared.

Moreover, in association to the above, the reader is advised to keep in mind the following methodological remarks:

The series of "private savings" in Figure 5 was derived by subtracting from the series of GNP the two series of total consumption and public savings. This implies that private savings include private domestic savings, transfers of private savings from abroad, like immigrants remittances and foreign exchange inflows for the purchase, say, of real estate, and all forms of foreign aid. As “public savings” I defined and measured the surplus or deficit in the budget of the central government. Hence, the series includes neither the results from decentralized state entities like the Local and Regional Authorities and the State Enterprises and Organizations, nor the guarantees the central government provides for the loans these entities receive directly from domestic and foreign credit markets. If data were available for them and their results were allowed for in the series, our view is that most likely public finances were in the red throughout the post war period. Finally, it should be noted that for reasons of improving the monitoring of state management more recently the EU introduced an accounting system with emphasis on the “General Government”, thus moving away from the traditional approach which focused on the finances of the “Central Government”. Under the EU accounting system the operating results of local authorities, state enterprises, various health and insurance organizations, etc., are all included in the accounts of the General Government, and hence, by looking in a single budget one can assess easily the course of state finances. In the present case though, to preserve the continuity of time series with the past, I focused on the budget of the Central Government. This implies that the results of the decentralized state authorities and organizations are subsumed in the series of total savings.

Foreign aid

During 1950-1969, investment was financed as follows: 11% or 55.5 billion drachmas came from public savings, 47.9% or 242.9 billion drachmas emanated from private savings, depreciation contributed 23.7% or 120.4 billion drachmas, and 17.4% or 88.4 billion drachmas represented transfers of savings from abroad, including foreign aid, which, during the period 1960-1969, cumulated to 3.06 billion drachmas. From these data it is clear that Greece continued to receive financial aid for many years after the end of the Marshall Plan in 1952. But all this assistance pales relative to that which began to flow from the European Economic Community (EEC) shortly after accession to full membership in 1981.

Table 1 shows the net inflows of receipts from EU. From this we see that over the last thirty years Greece received financial aid, which on aver-

age amounted to 2.7% of GDP per annum. Considering this finding in conjunction with the evidence from Figures 1, 3 and 5, the following questions come to mind. First, even though after 1981 the assistance from EU

Table 1: Net inflows of financial aid from the EU as a percentage of GDP

1981	0,003	1991	0,046	2001	0,031
1982	0,012	1992	0,039	2002	0,027
1983	0,016	1993	0,044	2003	0,020
1984	0,016	1994	0,041	2004	0,022
1985	0,017	1995	0,035	2005	0,016
1986	0,024	1996	0,048	2006	0,021
1987	0,029	1997	0,039	2007	0,018
1988	0,025	1998	0,039	2008	0,020
1989	0,029	1999	0,043	2009	0,009
1990	0,032	2000	0,043	2010	0,013

Sources: 1. Ministry of Finance, Introductory Report of the Budget, Athens, various issues.
2. GDP from the AMECO data base.

was extremely high, Greece experienced a period of economic stagnation which lasted until 1994. How can we explain the negative correlation between foreign aid and economic growth from 1981 to 1994? Second, after 1994 the average growth rate was higher than the average rate of assistance from EU. What happened and the correlation reversed? Did Greeks decide to take better advantage of EU aid? Was it due to changes in the administration of the aid from EU authorities? Or, is it the case that Greece returned to relatively robust economic growth for other reasons unrelated to EU aid? Third, Figure 3 shows that throughout the post 1981 period total fixed investment followed a declining trend. Given that EU aid aimed at promoting investment and structural change, why did total fixed investment decelerate,? Finally, fourth, referring to Figure 5, why did the percentage of saving in GNP continue to shrink despite the unprecedented scale of EU aid? The answers to this and the other questions raised above will occupy us later.

Borrowing

From Figure 3 we know that during the post war period public investment averaged 2.4% of GDP per annum, while from Figure 5 it follows that in the period before 1978 public saving averaged 1.1% of GNP per annum. Hence, since size wise GDP is normally less than GNP, the government

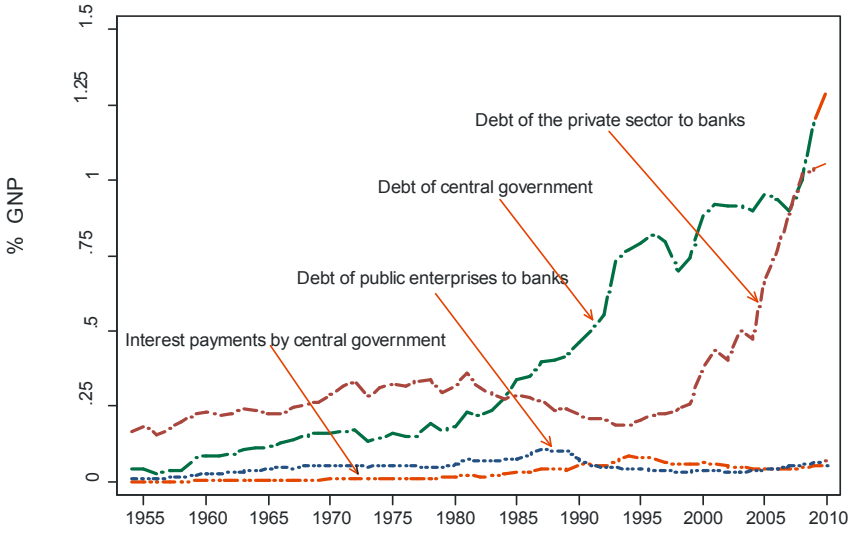


Figure 6

had to borrow on average less than 1.3% of GNP per annum to finance public investment. Figure 6 shows that in the period before 1980 borrowing by the central government fluctuated within this narrow limit. In turn, this modest borrowing in combination with the fast economic growth of the period resulted in the accumulation of public debt which in 1981 reached 22.9% of GNP. But thereafter the rate of borrowing by the central government exceeded many times the rate of public investment, even though at the same time Greece was receiving voluminous financial aid from EU. As a result of this exorbitant government borrowing in a period when economic growth slowed down significantly pushed the public debt to GNP ratio to over 125% in 2010. What all this implies is that, if public investment was restrained, it was not from the lack of investable resources but from the nature of policies that were pursued.

With respect to the supply of loanable funds to the private sector and the public enterprises, a good indicator is that of bank credit, which covers the demand for loans by business concerns and households. Figure 6 shows the balance of outstanding loans by banks to these activities. Observe that the debt of public enterprises remained throughout the period at a very low level by fluctuating around an average annual rate of 4.8% of GNP. On the contrary, private sector debt to banks evolved in two phases. In the first one, covering the period 1954-2000, the average annual rate of debt to banks varied around a horizontal trend in the level of 25.6% of GNP. But from 2000 there begun a second phase of massive borrowing,

which in 2010 raised the private sector debt to banks to 106.3% of GNP. More specifically, if we compare the slopes of the corresponding curves after 2000, it turns out that private sector debt grew faster than public debt, mainly because of the sharp increase of bank loans to households.

1.3 Structure and competitiveness

After 1973 there were indications that: (a) the structure of the Greek economy, which had served well in terms of economic growth in the two previous decades, was becoming increasingly inconsistent with the open economy environment that was emerging internationally, and (b) if the necessary structural reforms were not introduced in time, sooner than later the process of rapid economic growth would come to a halt. In addition, given that in the 1970s Greece applied for full membership in the EU, it was apparent that Greece ought to boost the competitiveness of its economy by reorienting its productive activities toward exports rather than sticking to the old model which was based on import substitution. Therefore, to prepare the ground for our assessment of the policies that were adopted, I shall begin here with a brief presentation of the salient features of the structure and competitiveness of the Greek economy in the post war period, with an eye towards the problems that needed to be addressed.

Employment

Because of the extreme poverty and the lack of employment opportunities that existed in the first post war years, many Greeks, more out of necessity rather than by choice, migrated to the USA, Western Europe, Australia, and elsewhere. However, despite the loss of valuable human resources, immigration helped in multiple ways the process of Greece's economic development. With the remittances to their relatives in Greece, immigrants contributed to the increase in effective demand and eased the constraint of the balance of payments. Through their visits to their homeland, immigrants brought from the countries where they lived new ideas and lifestyles; and not a few from the most successful ones returned to invest, to establish enterprises and to contribute directly to the development efforts.

Moreover, immigration helped reduce the excess demand for jobs and, in conjunction with the take-off in the 1950s and the robust economic growth that followed, it made possible to confront the problem of unemployment. The data displayed in Table 2 ascertain this realization quite clearly. In particular, observe from the last line that the unemployment rate fell from 5.9 in the 1950s to 2.1% in 1970s. But then, from the 1980s on, as economic growth faltered, unemployment increased again gradually and over the last decade it climbed to 9.4%. In this thirty-year period of rising unemployment, there was no new big wave of immigration. Rather on the

contrary, as more recent research has reported, the return migration flows became occasionally significant. Why did Greece become attractive to return to during a period of rising unemployment? I shall come to this question shortly.

Table 2: Changes in the level and the composition of employment[1]

	1951-60[2]	1961-70	1971-80	1981-90	1991-00	2001-10
Labour force[3]	3457,5	3504,0	3404,8	4044,6	4493,6	5050,8
Self-employed	2123,2	1976,8	1657,2	1712,2	1676,5	1639,2
Employees	1128,1	1357,0	1736,3	2084.5	2408,9	2939,2
Unemployed	206,2	170,2	71,3	247,9	408,2	472,4
% of unemployment	5.9	4.9	2.1	6.1	9.1	9.4

Notes: 1. All numbers are stated in thousands
2. Straight-line interpolations from the figures reported in the 1951 and 1961 censuses of population, National Statistical Service of Greece.
3. All other data come from the AMECO data base.

Table 2 is revealing also in other respects. One has to do with the changes in the composition of employment. If we calculate the percentage of self-employed in the total labour force, this fell from 56.4% in the 1970s to 32.5% in the last decade. Such rates of self-employed are not found anywhere in Europe. For example, Pirounakis (1997, 15), reports that in 1993, when the rate of self-employed in Greece was 47%, the figures were 29% in Italy, 26% in Spain and Portugal, 24% in Ireland, and only in Turkey it was 60%. Consequently, if someone surmised that the scale of production units in Greece, and hence, their productivity was lower than in European countries because of this reason, his view would be justified. Another interesting observation is the rapid increase in the number of people working as employees. At a time when economic growth slowed down significantly, what might explain the acceleration in this category of workers? In our view, a hint lies in the number of employees who were lavishly hired in the public sector by the parties in government. Finally, it should be noted that, while on the one hand measured unemployment was reduced by excessive hiring in the public sector, on the other it was augmented, particularly in the last two decades, by the influx of illegal immigrants, many of whom were naturalized and entered legally into the Greek workforce.

Sectoral employment and production

Table 3 shows the percentage distributions of employment and gross value added in the sectors of agriculture, industry, construction and services at the end of four periods. Looking at its columns from left to right and its rows from top to bottom, the data lead to the following findings:

Table 3: Distribution of employment and gross value added in four basic sectors during the 1961-2009 period

	1961		1981		2001		2009	
	% Empl.[1]	% GVA[3,4]	% Empl.[2]	% ΑΠΑ	% Empl.	% ΑΠΑ	% Empl.	% ΑΠΑ
Agriculture	53.4	21.3	27.4	14.6	15.7	5.7	11.6	4.3
Industry[5]	14.3	13.3	20.1	25.2	13.2	22.0	11.5	19.4
Construction	4.5	11.1	9.2	7.0	7.2	7.6	7.7	5.0
Services	27.8	54.3	43.3	53.2	63.9	64.7	69.2	71.2

Notes: 1. National Statistical Service of Greece, Census of 1961.
2. National Statistical Service of Greece, Census of 1981.
3. GVA: Gross Value Added.
4. Main source of other data: AMECO.
5. Industry includes manufacturing.

- Of the total labour force in 1961, 53.4% were employed in agriculture and contributed 21.3% of the total gross value added. Twenty years later, the respective percentages were 27.4 and 14.6. That is, in the period 1961-1981, employment in agriculture fell by 48.7%, while its contribution to domestic production declined by 31.5%. The restructuring that was expected to take place by shifting employment away from agriculture and towards other sectors did materialise and as a matter of fact it did so successfully, since productivity in agriculture increased. But after 1981, employment continued to decline and agricultural production was marginalized.
- The last finding, combined with the significant EU aid to farming after 1981, raises many questions. Some are the following: A large part of the EU aid aimed at defraying the cost of restructuring. In particular, it aimed to enlarge the average size of agricultural lots; to introduce new crops; to train farmers in production and marketing methods, etc. Were the policies that the authorities implemented consistent with these objectives? If they were, why did they fail? If they were not, what happened and Greece, which was self-sufficient in agricultural produce in 1960, in 2009 imported a great deal of farm products from abroad? To these questions I shall return in the explanatory part of our presentation.
- By 1981 the sector of industry had made significant advances.[9] In particular, it share in employment increased by 40.6%, i.e. from

[9] According to the results obtained by Drakopoulos, Theodosiou (1991), most of the robust growth in GDP came from industry.

14.3% in 1961 to 20.1% in 1981, while its contribution to domestic production increased by 89.5%, i.e. from 13.3% in 1961 to 25.2% in 1981. From 1981 on industry entered a period of slowdown. But the data in Table 3 show that the degree of de-industrialization was moderate, since from 1981 to 2009 the shares of industry in employment and in gross value added fell by only 13.5% and 3.4% respectively.[10]

- In the construction sector employment increased from 4.5% in 1961 to 9.2% in 1981, while its contribution in gross value added in the corresponding period fell from 11.1% to 7%. Since then, the percentage of construction workers in total employment stabilised around 7.5%, while the contribution of this sector in gross value added fell slightly to 6.3%.
- Unlike the above sectors, the shares of services in employment and gross value added increased continuously. In particular, employment, which accounted for 27.8% of the total in 1961, rose gradually to 69.2% in 2009, whereas in the same period its contribution to domestic production increased from 54.3% to 71 2%.

From the above it follows that, while the Greek economy during the period 1961-1981 achieved a structure of employment and production that was characterized by pluralism and complementarity in the fundamental economic activities, in 2009 two-thirds of its structure was dominated by one sector, i.e. that of services. But looking deeper into this sector, we find that services itself was dominated by two activities, i.e. tourism and maritime transport. As a result, the Greek economy has become highly unstable, because it is based on two activities that are highly sensitive to changes in the international business cycle and other exogenous forces.

Rise and fall of competitiveness

Table 4 shows the gross value added per employed worker in the four sectors shown in Table 2 for Greece and the EU in its various stages of enlargement. Based on the data from this table we can see how productivity evolved in the respective regions and bring to the forefront the problems of competitiveness that emanated from this source in the successive stages through which the integration of Greece into EU took place. From the first two columns of this table we observe that when Greece applied to join the customs union of Europe in 1959, with the exception of the construction industry, productivity in Greece lagged far behind the average productivity in all sectors of the EU. In particular, productivity in agriculture and indus-

[10] Katsoulakos, Tsouris (2002) found that the competitive position of industry within EU did not change much. One year earlier, Louri, Pepelasis-Minoglou (2001) had arrived approximately to the same conclusion.

Table 4: Productivity per employed in Greece and in EU, Thousands of Euros, Constant prices of 2000

	1959		1981		2001		2009	
	Greece[1]	EU[2]	Greece	EU[3]	Greece	EU[3]	Greece	EU[4]
Agriculture	2,79	8,24	14,54	10,61	11,68	22.36	13,68	29,66
Industry	3,38	9,75	17,98	31,71	30,01	53.38	32,98	56,88
Construction	18,57	18,11[5]	20,71	32,71	34,42	34.45	23,67	34,08
Services	3,79	8,58	33,60	41,91	32,86	47.94	37,43	49,31

Notes: 1. Estimates based on AMECO data for 1960 and the proportions reported in Higgins

2. EU of 6 countries: Belgium, France, Western Germany, Italy, Luxemburg, and Holland.
3. EU of 11 countries: Belgium, Denmark, France, Greece, Holland, Italy, Luxemburg, Portugal, Spain, United Kingdom, and Western Germany. For Ireland there existed no data. The averages were computed using as weights the number of employed in nonmilitary positions. However, the estimates turned out to be quite robust to using various other weights.
4. EU of 12 countries: Belgium, Denmark, France, Greece, Holland, Ireland, Italy, Luxemburg, Portugal, Spain, United Kingdom, and Western Germany
5. The estimate for 1959 was based on the simple average of Gross Value Added per employed in France, Western Germany, and Italy for 1960.

try was one third of the respective figures in the EU, whereas productivity in services lagged slightly less, since in this sector it was close to 45% of that in the EU.

To facilitate the comparisons between Greece and the EU through time, from Table 4, I derived Table 5. From this we observe the following:

Table 5: Comparison of productivity per employed in the four main sectors in Greece and in EU

	1959	1981	2001	2009
Agriculture	0,34	1,37	0,52	0,46
Industry	0,35	0,56	0,56	0,58
Construction	1,03	0,62	1,00	0,69
Services	0,44	0,77	0,68	0,76

- In the period 1959-1981, Greek agriculture covered its productivity shortfall in comparison to the EU and at the same time gained a sig-

nificant competitive advantage.[11] However, after 1981 its competitiveness regressed back to the levels of 1960.

- Until 1981, industry and services improved their productivity in comparison to the corresponding sectors in the EU. But ever since their productivity ceased to converge, thus adding to the forces which caused these sectors to lose shares continuously, both in domestic and foreign markets.[12]
- In reference to the construction sector, what we observe is that its productivity evolves in a wave like pattern, with peaks in the periods of excessive construction pressure (1959, 2001). This implies that its productivity is driven primarily by demand and only secondarily by supply side conditions.
- In view of the preceding, the spectacular economic growth during the period 1954-1973 could be sustained only through continued and rapid gains in the productivity of the large and ever-expanding services sector. Unfortunately, this did not happen because, as corroborated by the figures in the last rows of Tables 4 and 5, the productivity in this sector stagnated at the 1981 levels.

However, apart from productivity, the competitiveness of a country's products and services depends on many other factors. If, for example, employer contributions to health and pension funds are higher in Greece than abroad, with similar levels of productivity, the goods and services produced in Greece will be less competitive. The same applies if the interest rates on business loans are higher, if bureaucracy and corruption give rise to increased transaction costs, etc. These factors influence competitiveness by creating a wedge in the prices of goods and services among countries. Thus, in order to trace the extent and the direction of the influence that all these factors exercised on competitiveness, Table 6 shows in the third row the average levels per decade of the differential inflation in Greece and the EU. From this index it turns out that in the 1960s the rate of inflation in Greece was less than in the EU. As a result, since the prices of goods and services increased less Greece than in the EU, Greece experienced gains in competitiveness, both because its productivity increased at a faster rate and its economic environment was characterized by greater price stability. But starting from the 1970s this trend reversed because, relative to the EU, in Greece: (a) there took place a sharp slowdown in productivity, and (b) the prices of products and services increased more rapidly, since in the 1980s and 1990s inflation was 4 times as high as that in the EU.

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[11] Our estimates, based on data from the National Statistical Service of Greece and AMECO, show that the competitive advantage of Greek agriculture in 1981 was 37%.

[12] Aristotelous (2008) found that, after adopting the euro in 2002, Greek products and services lost competitiveness relative to the other countries in the Eurozone. As a result, Greek exports to these countries declined.

Table 6: Comparison of inflation and the real unit labour cost in Greece and in the EU.[1]

	1961-1970	1971-1980	1981-1990	1991-2000	2001-2010
Inflation in Greece[2]	3.0	14.8	19.6	9.6	3.0
Inflation in EU	4.6	9.3	5.5	2.0	1.9
Differential inflation[3]	0,6	1,6	3,5	4,7	1,6
Real unit labour cost	1,12	0,91	1,07	1,00	1,31

Notes: 1. EU of 12 countries mentioned in Note 4 of Table 3.
2. The rates of inflation were computed using the implicit deflators of GDP with basis 2000=100.
3. The differential inflation was computed as the ratio of inflation in Greece divided by inflation in the EU.

The figures in the last row of Table 6 depict the time pattern of changes in the ratio of the real unit labour cost in Greece and the EU. This, in conjunction with Figure 2 and Tables 5 and 6, suggests the following remarks:

- According to Table 6, before 2000 the real unit labour costs in Greece and the EU were roughly equal. To the extent that they differed, their differences were limited and fluctuated around 1,025 for the entire period. But after 2000, the real unit labour cost in Greece exceeded that in the EU by over 30%.
- From Figure 2 it turns out that in the period 1954-1973 labour productivity in Greece followed a strong upward trend. Moreover, Table 5 showed that in the same period labour productivity in Greece grew faster than in the EU, whereas Table 6 shows that the prices of Greek products and services rose at a slower pace than in the EU. Consequently, the finding that during this period Greek workers were paid 12.5% more per unit of labour relative to the workers in the EU is as one would have expected. In other words, the benefits of greater labour productivity in an environment of greater price stability rendered Greek products more competitive and through increased exports enabled a relatively better remuneration of Greek workers.
- After 1973 and until 1993, labour productivity moved on a horizontal trend, while inflation in Greece accelerated much faster than in the EU. The result was that the competitiveness of Greek products and services slowed down significantly and the deficit in the balance of payments widened. Table 6 reveals that during the period 1971-1980 an attempt was made to offset the slowdown in produc-

tivity with a downward adjustment of the real unit labour costs. But after 1980, this effort was abandoned and the losses in competitiveness increased and consolidated.

- After 1994 labour productivity started to rise again (see Figure 2). But, as shown in Table 5, its increase was smaller than that in the EU, and hence, Greek products and services lost competitiveness. Meanwhile, the economic policies that were adopted not only did not reduce the unit labour cost, so as to offset the losses in competitiveness that emanated from the slowdown in productivity and the differential inflation, but on the contrary they increased it further.

On account then of the decline in competitiveness, the explosion of deficits in the balance of payments emerged naturally and became systemic because, as Nicoletti, Scarpetta, Boylaud (1999) and others have stressed, even before entering the European Monetary Union (EMU) Greece had more regulations on the markets for goods and services and more restrictions on the labour markets than all other countries in the EU.[13]

Centrally controlled and directed markets

Given the emphasis that policy makers placed on import substitution and command or top-down administered approaches to economic growth, the regulatory and structural policies they adopted were as they could be expected. To seal the economy from foreign competition, they erected high walls of trade and non-trade barriers. To direct loanable funds to investment and productive activities in sectors they considered growth enhancing, they set up a system of unparalleled administrative complexity to control the financial system; and last but not least, to regulate competition in the domestic markets they adapted various policies from centrally planned economies. The result was that in the first two post war decades the Greek economy was transformed into a nearly planned economy in which efficiency in the use of resources, export orientation in productive activities, and competitiveness in terms of world standards, were considered objectives of secondary importance. For these reasons now it is recognized that, the remarkable economic growth that was achieved during this period slowed down afterward because Greek governments not only failed to introduce the reforms that were necessary, as national economies started to open up and integrate into the global economy, but also because they adopted policies which worsened significantly the competitiveness of domestic goods and services.

[13] At the same time, according to Schmidt (2008, 435), relative to all countries in the EU, Greece had the largest safety net covering workers and labour unions.

To corroborate this view, consider first the policies in the financial sector. As documented by Bitros (1981), Halikias (1978), Pagoulatos (2003) and other researchers, until fairly recently money and capital markets functioned under strict qualitative and quantitative administrative controls. Contrary to the orthodox monetary policy, the central bank, i.e. the Bank of Greece, did not aim at controlling the quantity of money or some basic interest rates. Monetary authorities micromanaged the distribution of investable resources by determining which sectors of the economy would be provided with bank credits and to what extent, what interest rates would be charged, etc. Each year credit policies took the form of the so-called monetary program, which constituted a centrally controlled system for the allocation of bank credits and the pricing of bank deposits and loans. Main drivers of this program were the banks and the special credit institutions which operated as a fairly tight oligopoly. This structure was socially condoned because, in a society where even today the government enjoys the status of a benevolent "protector" and "saviour", free money and capital markets could not be trusted to serve the interests of citizens better than state banks. Unfortunately, using their economic power as well as their connections in the political market, these banks merged financial with business capital, quashed the competitive functioning of markets, and vitiated the development of an autonomous, self-assured and outward looking entrepreneurial class.

Moreover, the multifaceted distortions that structural and regulatory policies introduced in product and labour markets did not go unnoticed by a few farsighted researchers.[14] But to no avail! There ought to pass six decades of destructive government forays into the self-coordinating market mechanisms. Greece had to come face-to-face with the spectre of bankruptcy; and, lately, the crisis became so explosive that the International Monetary Fund (IMF) and the European Union (EU) had to step in and demand reforms, which would lead to the demolition of the post war model of economic growth.[15] In our view the above structural features are too important to downgrade or ignore, as most researchers of the Greek economy usually do. For this reason I shall return to them later to explain their catalytic consequences.

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[14] On the basis of price controls and barriers to entry of enterprises in the sectors of commerce and investments, according to Mylonas, Papaconstantinou (2001, 505), in 1998 Greece was ranked as the most illiberal country in EU.

[15] How difficult the transition to a more competitive model in the economy is going to be, it emerged in a recent discussion in parliament regarding the issue of opening up all closed professions. The two major political parties did everything in their power to avoid or postpone implementing the obligation they had been forced to accept via the "Austerity Program". Unfortunately, more in the conservative party than in the socialist one, the overriding characteristic is their statism and their devotion to catering towards special interests. This we consider to be the biggest problem of Greece at present.

1.4 Deficits and debt

Countries like Taiwan, South Korea and Singapore opted for economic growth models in which aggregate demand is driven by exports. Unlike them Greece chose the model of a quasi-closed economy in which aggregate demand is determined by import substitution. In our view, the policies that were adopted under this strategic choice, distorted the structure and undermined the international competitiveness of the Greek economy to such an extent that throughout the post war period its operation was characterized by several key imbalances. Among them the ones referred to below are most noteworthy.

Swelling of the public debt

By virtue of the loan agreement imposed on Greece by its creditors, as well as the measures of extreme austerity that the government continues to adopt, today even the most unsuspecting citizens know that Greece is on the verge of bankruptcy. Why and how it arrived at this critical juncture will occupy us a bit later. But in order to avoid the need for backtracking to discuss the responsibility of public policies, it is convenient here to make a small digression to highlight the magnitude of the fiscal problem and how difficult it is to confront it.

In general, as long as the cost of borrowing is less than or equal to the return of investment financed by loans, borrowing is beneficial because the wealth of borrowers increases. But if the cost of borrowing is greater than the return of the investments which are financed, borrowing becomes burdensome. Moreover, the situation for the borrowers becomes even harder, if they use the proceeds from the loans not for investment but for consumption. Based on this analysis, Figures 3, 5 and 6 warrant the following remarks:

- According to Figure 6, the interest payments by the Central Government on its outstanding debt climbed, and in some recent years exceeded, 5% of GNP. These outlays, in combination with the fact that the debt is held now largely by foreign creditors, widened the deficit in the balance of payments and by feeding back to the public debt destabilized the economy.
- From Figures 5 and 6 we observe that after 1981 government saving entered a declining trend, which resulted in a particularly rapid increase of the debt of the Central Government. Maintenance of the rising public debt would be feasible if: (a) the proceeds from the loans had been used to finance public investment; (b) public investments had accelerated economic growth, and (c) economic growth had increased public revenues so as to cover the required outlays for the payments of interest and amortization instalments.

But from Figure 3 we observe that public investment stagnated at around 2.4% of GDP per annum. Therefore, since government borrowing was used mainly to finance public consumption, it was to be expected that economic growth would decelerate, public deficits would swell and the government would become eventually unable to service public debt.

This is precisely the impasse Greece faces today and the challenge is how to return to the path of robust economic growth, so as to repay creditors without big losses in national sovereignty, credibility and pride.

What happened in the balance of payments

Figure 7 shows how the import and export of goods, the imports and exports of services, and the inflows and outflows of incomes and other transfer payments, determined the opening in the balance of payments, which had to be covered by transfers of savings from abroad. All series come from the AMECO data base, they cover the period 1960-2010 and are stated as percentages of GNP. In conjunction with the remarks made earlier, in reference to the changes in the composition of output, productivity and competitiveness, we observe the following:

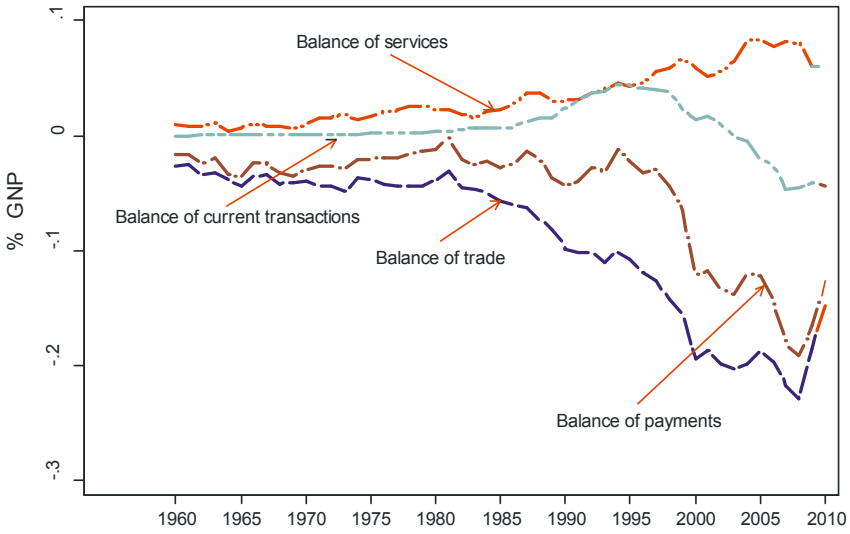


Figure 7

- The balance of the trade account has been negative throughout the post war period. But while due to the rising productivity and competitiveness of Greek products the deficits until 1981were maintained down to 4% of GNP on average per annum, since then the

deficit kept increasing and in 2010 it reached 14.4%.

- The balance in the account of services has been consistently positive. In particular, by virtue of the increased productivity and competitiveness that the industry of services achieved before 1981, the surpluses from this account contributed increasingly to meet the expanding trade deficits.
- After 2005, the surpluses from the services account started to show signs of fatigue most likely because: (a) Greece lost the ability to offset the losses in competitiveness through currency devaluation; (b) losses of competitiveness in the tourist industry accelerated by the dynamic entry into this sector of neighbouring countries, and (c) the recession that plagues the world economy in general and the shipping industry in particular.
- The net balance from income transfers and other current transactions with foreign countries, which was positive and increasing until 1995, initially slowed down and eventually turned negative. At a time when Greece was receiving significant aid from the EU, this development suggests that the outflows mainly for the payment of interest on the growing foreign debt began to contribute significantly to the balance of payments deficit and to add to its continuous enlargement. That this is what happened I am fairly certain because, as recent research has shown, the need for interest payments on foreign debt in the order of 5% of GNP rendered the imbalances in the balance of payments non sustainable.

In turn, the last point implies that the deficit in the balance of payments after 1981 did not become unsustainable exclusively because of the losses in competitiveness of the Greek economy. It became unsustainable also because of the big deficits that fiscal policies and management generated, which led to the accumulation of an unsustainable amount of public debt. Although from the presentation in Section 1.3 the reader may have appreciated the magnitude of the problem that government operations created since 1981, for reasons of completeness, the following brief account regarding the imbalances in the social security system is imperative.

The actuarial debt of social security

Under the current system the payment of pensions is based on three sources of revenues. These are: (a) the contributions of employers and employees; (b) the returns from the investments of the reserves, and (c) the reserves themselves. Later I shall have the opportunity to highlight the enormous responsibility of governments in their disastrous policies and management of the social security system. But here the goal is different. In particular, what I wish to do is to approximate the present value of reserves that the social security system ought to have in order to be able to

cover the outstanding claims of policyholders. As pension funds lack this reserve, their shortfall is considered public deficit, which even though it does not translate into government bonds or treasury bills traded daily in the stock exchanges, it generates growing obligations for governments in the future.

The first two post war decades there was no problem. Since the ratio of workers to pensioners was high and real incomes were increasing, annual expenditures were more than covered by contributions and hence reserves kept increasing. But by the late 1970s, the ratio of workers to pensioners started to decline, whereas simultaneously economic growth slowed down, thus retarding contributions and eroding gradually the reserves. As a result the social security system entered a period of growing deficits. The study by OECD (1997) describes and evaluates all the reforms made since then in order to confront the problem. Unfortunately, none of these reforms was sufficiently radical to reverse the downward trend and the net liabilities of the social security system to policy holders from the one year to the next continued to grow. For example, OECD (1997, 93) experts calculated that at that time the present value of unsecured liabilities of the social security system amounted to at least 137% of GDP.

In the years since then governments initiated several reform efforts towards a tripartite scheme of funding, with a commitment on the part of the state to contribute annually one percentage point out of the GDP growth. However, as shown by studies from different institutions, the situation continued to deteriorate and the actuarial deficit of the social security system to date is probably more than 150% of GDP. So, under the extraordinary financial conditions that emerged in 2010, the horizontal reduction in pensions, the mandatory prolongation of working years before retirement, and the tightening of conditions for early retirement, came naturally. However, none of the reforms of the current redistributive pension system has reversed the upward trend in the actuarial debt. What is needed is a reform towards remunerative pension schemes, whereby citizens themselves will assume the responsibility for the funding of their retirement plans, as well as looking carefully after the management of their savings over the span of their working lives.

1.5 Summary of findings

The performance of the Greek economy in the post war period may be distinguished into three phases. These are: (a) the phase 1954-1973 of high economic growth, b) the phase of moderate growth from 1974 to 2008, and (c) the phase of negative growth, which started in 2009, continued in the years 2010-2011, and according to all indications it may last for one or two more years. During the first two phases, the economy grew respec-

tively at average growth rates of 6.9% and 2.4% per annum, whereas in the period 2009-2010 the economy shrunk at an average annual rate of 3.3%.

Throughout the post war period public investment ranged around 2.4% of GNP per annum. This finding, coupled with the very large increase in the debt of central government, especially after 1981, implies that the construction of infrastructure: (a) was not constrained by the lack of available investable resources, and (b) the effect of infrastructure was neutral in the sense that it neither accelerated nor slowed down economic growth in the two first phases. Therefore, the observed differences in the rates and in the volatility of economic growth between 1954-1973 and 1974-2008, derived mainly from private investment. Regarding the latter I found that, while the trend in the first period was strongly upward, in the second period it turned downwards, because the rise in business investment after 1979 was not robust enough to offset the strong decline in residential investment.

In principle the decline in private investment after 1974 might be due to shortages of investable resources. To highlight this possibility, I turned my attention to saving. I found that the strong negative trend which took hold after 1974 was not moderated, not even after 1981, when the aid from EU started to flow at the average rate of 2.7% of GNP per annum. The reasons as to why saving slowed down after 1974 will occupy us later. But for now it suffices to point out the supply of saving did not constrain at all private investment because: (a) the demand for residential housing decelerated for other reasons; (b) due to highly restrictive regulations, bank loans to citizens for consumption purposes were extremely limited, something which is also corroborated by the finding that private sector debt to banks prior to 2000 amounted on average to 25.6% of GNP, and (c) after 2000, when money and capital markets were liberalized, banks offered abundant loans to households and businesses on quite lax terms and elevated risks. Rather on the contrary, the data show that the supply of loanable funds was so big that the debt of the private sector to banks, which in 2010 climbed to 106% of GNP, together with the debt of the central government, which in the same year was 130% of GNP, brought the economy to the verge of bankruptcy.

Until 1981 employment in agriculture was shrinking and productivity increasing. Since then, while employment continued to decline, productivity slowed down. The industry, which before 1981 contributed strongly to both employment and economic growth, afterwards it entered a prolonged period of contraction. However, the segment of industry that survived managed to increase its productivity, thus enabling it to maintain its competitiveness vis-à-vis the EU and to contribute somewhat in the moderation of the slowdown in economic growth. In the construction industry, where competitiveness relative to the EU was characterized by periods of sharp deceleration (1981, 2009) and sharp acceleration (2001), productiv-

ity increased steadily until 2001. But as this sector was relatively small, its contribution to economic growth was limited. Under these circumstances, the slowdown in the economy could have been averted only if productivity and competitiveness accelerated significantly in the ever-expanding service sector. This did not happen. Nor could it happen because of at least two main reasons. First, because the opening of economies to international competition, which was precipitated in the 1970's, revealed the structural deficiencies that the Greek economy had inherited from the earlier policies of an inward looking economy with centrally controlled and directed markets; and, second, because after 1981 there emerged serious macroeconomic imbalances. In particular, public deficits increased as a percentage of GDP and led to the accumulation of unsustainable public debt. The balance of payments was pushed deep into the red by losses in the international competitiveness of Greek products and services. And last but not least, the mindless increase in the number of pensioners and the level of pensions increased the actuarial debt to such a height that it is now impossible to address without painful structural reforms.

2. Why things came upside down

After the great economic crisis of 1929, economists in general suspected that some policies that were suitable before, they were inappropriate after. But while the vast majority of researchers were interested in explaining the causes of great depression and prescribe economic policies to prevent its recurrence in the framework of the established social and economic order, a few others searched for answers without this restriction because in their view the crisis was due to the core structure of the order itself. Unfortunately, unlike what happened in Western countries, in Greece dominated the ideas and policy prescriptions of the opponents of the open society and market economy. Nowhere is their influence more apparent than in: (a) the institutional arrangements by means of which collective entities such as the “nation”, the "state", the "society" and the “political parties” were endowed with rights over and above those of the individual, and (b) the economic policies through which markets were replaced by administrative processes of central direction and control. Here we shall explain why the developments in these two fronts could bring about nothing more and nothing less than the results that I reported in the previous section.

2.1 Effects of changes in institutions

From Institutional Economics we know that the structure of a market economy, and therefore its propensity to grow or regress, is strongly influenced by which institutions administer the functions of the state, what mechanisms ensure the enforcement of checks and balances among them, how well protected are individual freedoms and property rights in the law

and in practice, etc. Therefore, in order to understand the nature and extent of the influences that the changes in institutions exerted on the Greek economy, it is necessary to identify the trends that prevailed and to specify the outcomes that we would expect to result. That is why the presentation below focuses on this subject.

2.1.1 One party governments

During the period 1944-1952 Greece was governed by coalition governments. The view that prevails among political analysts is that these governments were weak. However, judged on the basis of what they accomplished, to us it appears that they governed with considerable flexibility and effectiveness. Since then Greece has been governed by one-party governments, with all the cons that this entails in an environment of fierce partisan competition.

Why have political parties in Greece shun cooperation? The usual explanation is that cooperation is not possible because the differences in their programs are too big to converge. But as we know, this is not true because the two parties that governed Greece in the last three decades, i.e. the Pan-Hellenic Socialist Party and New Democracy, have very similar political agendas. For example, they are in favour of democracy with a free market economy, albeit with some differences in the degree of state controls and regulations, they promote the country's participation and integration into the EU, they pursue similar foreign and defence policies, etc. Rather the cause for their obsessive insistence on one-party governments should be sought in their inclinations to serve not the interest of all citizens, but those of their own and their civil and business clients. This explains why they will do anything, legal or illegal, moral or immoral, etc., to trap their constituencies, with the result that democracy in Greece combines with free markets in a grossly substandard way. Therefore, if Greek voters are to stop acting as 'buyers of favours" by politicians, to use the characterization by Downs (1957, Chapter 6, IV), it is urgent to adopt constitutional reforms that will re-establish the sovereignty of citizens over politicians and political parties, cut down on fractious politics, and impose conditions of full accountability and transparency on all individuals who are elected or appointed to public offices.

2.1.2 Progressive government supremacy

A second trend that prevailed was the transfer of overwhelming powers to the government from other decision making centres in the Greek democracy and economy. This trend appeared for the first time in the constitution of 1952 which, inter alia, granted the government rights to appoint the top justices and to supervise the educational system. Then it increased by a

quantum leap in the constitution of 1975, which widened the immunity of the members of parliament, provided for state finance of the political parties, authorized the government to restrict property rights and to intervene in the civil service, in the labour unions, in all forms of cooperatives and associations of individuals, etc. Finally, it culminated in the 1986 revision of the constitution with the transfer from the President of the Republic to the government of the right to dissolve the parliament and to call for elections. Therefore, it is not surprising that gradually Greece slipped into a command regime, in which the government by controlling all levers of political and financial powers became invincible.[16]

Did this trend contribute to the slowdown of economic growth after 1974? Our view is that it did for at least three reasons. The first is that, in order for the concentration of executive power to work effectively, it must be supported by a system to coordinate the decisions taken by various ministers, to evaluate outcomes that result from their implementation, and a dynamic feedback process to revise and adjust the decisions in the light of the results achieved. For Greek governments, which as a rule: (a) comprise more than 40 ministers and deputy ministers, (b) have to work with a civil service split across party lines, (c) take decisions more on intuition than on real time information, etc., the great probability is that they do not have such capabilities. Nor should it be ignored that, as the leadership in the two political parties that alternate in government is more or less hereditary, concentration of power inhibits the diffusion of information, propagates favouritism, and erodes trust at all levels. To express the above in the more familiar terms of Olson (1982, Chapter 1), democracy and economy in Greece have been reduced to a "hydrocephalous" structure in which the power of decision-making by autonomous and independent institutions has been usurped by governments in the name of citizens, but essentially in the service of a closely knit and controlled group of political and economic interests.

The second reason relates to the advantage a decision maker enjoys depending on the distance from which he knows the issue upon which he is called to decide. For, the decision makers who face the issues daily have more information about their various aspects and priorities than one who is in the centre and obtains his information from the reports of "experts". What the concentration of powers in the central government does is that it

[16] Some may object to this remark on the grounds that from the beginning of the 1990s there emerged a trend towards establishing decision-making entities quite independent from the government. The case has to do with the so-called Independent Administrative Authorities like, for example, the Competition Committee and the National Committee on Telecommunications and Posts. These authorities, aside of the narrow domain of their activities, it is uncertain how independent they are, since their boards and managements are all appointed by the government.

transfers the authority of decisions from those who live and have an immediate interest in the solution of problems to distant politicians and technocrats, who by approaching the problems from their point of view and deciding on limited information, frequently fail to act effectively.

Finally, the third reason is that the concentration of powers in the central government undermined the flexibility and resiliency of the Greek democracy and economy to respond to domestic and external socks. For example, in the face of the current economic crisis, very few doubt that the responsibility for the failure to introduce the necessary structural reforms after 1974, and especially after the accession to full EU membership in 1981, rests with the politicians who propagate the preservation of the political system.

2.1.3 Increasing lack of credibility, accountability and transparency

With the exception of the period 1967-1974, when Greece was governed by a military regime, all governments since 1952 were one-party governments. Hence, in principle, their pre-election proclamations ought not to differ from the policies they pursued when in government, or at least not to differ significantly. The reason is that, if a government found that it lacked the necessary parliamentary majority to implement its program, to maintain its credibility, it ought either to resign and call for elections, or form a coalition government to implement its main pre-election promises. Instead what happened is that governments pursued policies vastly different from the ones they presented to voters. The trend on the part of governments to deceive voters was felt in Greece soon after 1974 and accelerated particularly in the years since 1981 under the disruptive partisan competition that the socialists introduced into the political arena. As a result, after a while citizens got disappointed and started to modify their behaviour either to guard against the adverse consequences or to take advantage of the opportunities that arose from government inconsistencies.[17]

Actually governments did everything in their power to betray the trust of citizens. To corroborate this assertion, consider the trends that emerged from the successive revisions of the constitution. The privileges of the members of parliament widened; their immunity against offences that concern even their private lives destroyed the principle of equality in front of the law; political parties were given rights that enabled them to transform the political market into a well-guarded oligopoly, etc. If to these aberrations we add the despicable laws that governments enacted, as well as the

[17] In turn, as it was to be expected, the lack of credibility on the part of the governments led citizens to lose their confidence to the laws and the moral commitment of the governments to apply them equally in all directions. In Bitros, Karayiannis (2010) we report that this distrust hold especially among younger entrepreneurs.

parliamentary manoeuvres they employed, to protect their members and their clients, it is not surprising that nowadays citizens demonstrating in the street of Athens and elsewhere demand the abolition of the current political system and a return to a politics with more accountability and transparency on the part of the political parties. As for me, I believe firmly that the quality of Greek democracy and economy will not start improving until the constitution of 1975 is replaced by one in the direction of Western countries.

2.1.4 Partisan politics in the civil service

From the publication *Statistical Yearbook of Public Finance (1970),* of the National Statistical Service of Greece, it turns out that the number of civil servants, which in 1940 stood at 54,909, in 1952 climbed to 72,671. Credible analyses at that time suggest that this increase was unjustified. But the situation was even worse because these data counted only those who worked for the state in legislated positions and left out all others who worked also for the state but on a contractual basis. Indications about how large the employment in the state sector has always been, started to appear slowly through studies by various researchers and reports by national commissions, which were appointed to study the problem and propose measures to solve it. One of these studies found that the number of civil servants in 1961 was over 260,000, in 1971 over 320,000 and in 1981 more than 500,000, whereas the census that was conducted in 2010 showed that their number had swelled to 768,000. Hence, if we add those working in public enterprises, autonomous public organizations and other non-permanent positions, state employees were more than 1,000,000. By itself this number is the most fundamental structural distortion of the Greek economy, which I doubt that can be confronted with gradualist approaches like the rule "one hired for every five retired", even if it were applied strictly. That is why a one off reduction in the number of civil servants, by abolishing and/or merging ministries and dormant organizations, outsourcing public services to the private sector, expanding and deepening computerization, etc., is now more urgent than ever in the past. Otherwise the inefficient and bureaucratic public administration will continue to vitiate all efforts to confront the country's current economic crisis.

Aside from using public employment as a means to meet the demand for well-paying jobs by their supporters, and thus perpetuate their tenure in the government, the two political parties that governed Greece in the post war period undermined civil service through yet another process. This took the form of labour unions. In particular, invoking the provisions of the 1975 constitution, they legalized and financed, usually in opaque ways, the establishment of labour unions all across the state sector. But soon the latter discovered that they could use their bargaining power to extract from governments all sorts of privileges and concessions. Even worse, after a

while they got loose from the control of the parties to which they held allegiance and imposed a regime of impunity for their members, resistance to reforms and rude behaviour towards citizens. In short they transformed into a state in the state. An indication of how impotent governments became vis-à-vis these unions is that the only bold decision of a recent government was to rid union representatives from the disciplinary boards of civil servants!

Moreover, it is worth noting that, as the antagonism of the political parties in the domain of civil service increased, meritocracy in the hiring and promoting of civil servants receded. In turn, this trend eroded the morale of capable people working for the government, reduced their willingness to take responsibility, and turned civil service into a morass of mediocrity and indifference. No wonder therefore that in this hour of crisis that the country needs effective implementation of the reforms to which it agrees to with its creditors to escape bankruptcy, the civil service is in disarray.

2.1.5 Assessment of institutions and public administration

Throughout the post war period the public sector employed many more employees than that it needed, civil servants had low human capital and were selected and promoted to a large extent by non-meritorious criteria, transactions with public services were overly costly and opaque, etc. However, before 1974 there was not much antagonism among political parties, labour unions were non-existent, the size of the public sector was small and, while institutions operated inefficiently, at least they got the job done. After 1974, both the institutions and the public administration acquired an unfriendly posture, if not an outright hostility, towards entrepreneurship and economic growth.

The beginning started with the 1975 constitution, which among other provisions and authorizations: extended the sovereignty of the political parties over citizens, eroded critically property rights, replaced individual by collective wage agreements, expanded the power and privileges of labour unions and provided for the funding of their activities from general taxation, created a host of artificial individual rights through which citizens lost their sovereignty and mutated to party clients, etc. In other words, this constitution offered the required institutional framework to introduce into the presumed regime of civil democracy and market economy the policies of a largely confused socialism, by means of which the state became from overtly until openly hostile to the principles and self-coordinating mechanisms of the open society and free economy. The political parties that governed Greece in the post war period destroyed in essence the separation of powers. Using to the extreme the rule “divide and govern”, they undermined the allegiance and collegiality among citizens in every walk of life, as particularly in critical domain of public ad-

ministration. In order to hide their own underground dealings, they encouraged illicit relationships with private interests, they looked the other way in cases of unlawful and immoral transgressions by their members, and they condoned impunity. And, for the purpose of ensuring the tenure of an alternating parliamentary "tyranny", they imposed a centrally controlled and directed regime on the Greek society and economy, while at the same time they agreed to apply the provisions of the Treaty of Rome and all subsequent Treaties through which EU authorities aspire to establish a civil democracy with an integrated free market economy! From all the foregoing it follows that the erosion of institutions and the public administration, especially after 1974, undermined economic growth and is primarily responsible for the fact that Greece is now one step before bankruptcy.

2.2 Effects of economic policies

According to Figure 1, the growth rates that were achieved before 1974 were very high indeed. Most likely they would have been even higher, if the economic policies that the Greek authorities implemented were not oriented towards a centrally directed and nearly closed economy, without aspirations to achieve international competitive advantages for domestic products and services. For reasons that we shall explain shortly, this growth model exhausted its potential in the 1970s. So the institutions and the economic policies that enabled it to perform well previously ought to be reformed in the direction of an open and internationally competitive economy. Not only nothing of this sort happened, but, as I corroborated in the previous sub-section, the basic institutions changed in the opposite direction and swept with them the structure of the economy towards a frenzied and rampant statism. Below I focus on the economic policies that help bring the economy of Greece to its knees.

2.2.1 Macroeconomic policies

Prior to 1974, macroeconomic policies made it possible to: (a) restore the vast damages that had been inflicted to the country's infrastructure during the German occupation and the civil war that ensued, as well as to expand the networks of transportation, telecommunications, water-supply, public schools, etc.; (b) encourage the inflow of foreign direct investment, which resulted also in the technological upgrading of the sectors that benefited; (c) accelerate private investment in housing and business activities; (d) balance public finances, and (e) stabilize monetary and credit policies under which: lending rates were kept low and stimulated private investment, the general price level increased only modestly and helped maintain the international competitiveness of Greek products and services, and the deficits in the balance of payments were contained within bounds that made it

possible to avoid the accumulation of a large foreign debt. These desirable results do not imply that the policies were free of undesirable side effects. Rather on the contrary their consequences were both very serious and in retrospect not unexpected. For example, the payment of extremely low interest rates on the reserves of social security funds, which were deposited in the central bank on a mandatory basis, is responsible to some extent for the problems faced by pension funds today. Or, for another example, consider the employment of excess personnel in the wider public sector, which comprises the state-owned enterprise and numerous autonomous state organizations. But the dominant character of policies was growth oriented and that is why the unemployment rate in the 1970s fell to the extremely low level of 2.1%.

On the contrary, macroeconomic policies after 1974, and especially after 1981, promoted consumption and discouraged investment and economic growth. This view is corroborated by all the indices exhibited in the various figures and tables above. For example, despite the slight upward trend of public investments, the private ones decelerated (Figure 2). Net foreign direct investment initially vanished and more recently became negative (Figure 4). The deficits in the public sector and in the balance of payments (Figures 5 and 7) became self-sustaining; and, although labour productivity after 1994 accelerated, inflation eroded the international competitiveness of Greek products and services. The result was that the economy entered a prolonged recession during the period 1981-1993 and then it recovered, but the rates of growth were insufficient to absorb all the workers who entered the labour force for the first time. Thus, as joblessness in more recent years climbed to unprecedented levels, the annual rate of unemployment during last decade averaged 9.1%.

When Greece joined the Eurozone in 2002, monetary authorities knew or ought to know that fiscal imbalances were incompatible with the interest rates financial market determined for the national public debt. Simply the levels of its development and public debt did not justify that Greece borrowed at rates 30-50 basis points over German rates and indeed in doing so for consumption purposes. Greek authorities had all the time and the means to drive interest rates higher, and thereby slow down consumption and most likely economic growth, but at the same time implement structural reforms through which economic growth would have been jumpstarted again on a permanent and elevated basis. They did nothing and for this reason the monetary authorities of this period, in a similar way as the earlier ones who imposed the highly distortionary mechanism of centrally managed differential interest rates, are historically censurable.

In summary, the evidence is that with small differentiations fiscal and monetary policies before 1974 were conducted along high economic growth footprints. The management of public budgets left at times small

deficits. But with the positive inflows of savings from social insurance schemes, foreign aid and the seigniorage from the Bank of Greece, governments were able to finance the restoration and expansion of infrastructure with limited domestic and external borrowing. From 1974 on the earlier regime of macroeconomic policies changed mainly because of the sharp partisan competition that emerged in the political arena, which trickled down quickly to all levels of the Greek society. The result was that the state and the public budget became spoils for politicians, tightly organized minorities and interlocking groups of business interests.[18] The apologists of the regime that took hold claim as success that from 1994 onwards the country returned to decent rates of economic growth, which were significantly higher than the average growth rates of the EU. I agree with this assessment, in as much as economic growth emanated from the acceleration of labour productivity and fixed business investment (Figures 2 and 3). I agree also that it was successful in that it facilitated the entry of Greece into the Eurozone. But, as the dividend of economic growth was directed by fiscal policies once again to consumption, economic expansion in the light of growing budget deficits and public debt was due to expire and did come to an end when the global financial crisis erupted in 2008.[19] This explains why in 2009 and 2010 the Greek economy shrank by 2.3% and 4.3% respectively, while public debt climbed to 140% of GDP.[20]

[18] All indications are that Greece constitutes a typical example that confirms fully the theory of Olson (1965), according to which tightly organized pressure groups have the ability and do use it to extract from governments benefits that burden all citizens.

[19] Europeans suspect that Greece was accepted in the Eurozone on the basis of data that had been "massaged" to look better than they were in reality. To explain the source of their suspicion, let as return to Figure 5. From this we observe that from 1995on Greek governments started efforts to reduce public deficits down to the Maastricht limit. Their efforts paid off in 1998-1999. But these years were very crucial because they were the years of observation, which would predicate the decision of the EU authorities. At that time everything was ok and no suspicions would have arisen, if the stabilization of public finances was permanent. However, public deficits started to accelerate again soon after the years of observation. According to Katsimi, Moutos (2010), as long as the Greek governments were obliged to introduce measures to gain entrance into the Eurozone, they did so. Afterwards, when the coercion from the EU rules was not that coercive, the Greek governments return to their old practices whereby they increased public expenditures to gain re-election. Thus, in the light of the difficulties to reduce public spending, Eurocrats are justified to suspect that the data were "massaged" and that stabilization policies never were applied in reality.

[20] We remind our readers that mainly because of public borrowing, domestic and foreign, Greece went bankrupt five times since 1821. These incidences took place in 1826, 1843, 1860, 1893, 1932 and in all Greece was obliged to make concessions to its creditors which reached up to surrendering its national sovereignty to "Big powers" (see, Reinhart, Rogoff, 2009, 96). Moreover, Greek governments have used frequently the "practice" of inflation to reduce in real terms the obligations of the state towards domestic creditors, i.e. Greeks.

Unfortunately, after 1974, aside of fiscal and monetary policies, other macroeconomic policies exercised similarly adverse effects on economic growth and competitiveness. Some of them undermined further whatever flexibility existed in labour and goods markets. Such were, for example, the policies that introduced restrictions to the: (a) minimum wages; (b) conditions for recruiting employees (probationary period of employment, individual or collective contract, fixed or indefinite term of work assignment); (c) firing of employees (massive layoffs, timing of warning, severance pay, consultation procedures prior to notification of redundancies); (d) determination of working time (overtime, part-time, shift work, work on public holidays), (e) level of negotiation with employees (enterprise, sector), etc.[21] Obviously, these restrictions introduced multiple rigidities in labour markets, which impeded the movement of employees among the available jobs. Therefore, it is not surprising that the representatives of the country's creditors demanded and the Greek government was compelled recently to abolish many of these restrictions and to loosen up the rest.

By still other policies governments extended the activities of the public deep into the private sector and to a large extent they misused them. Prior to 1974, State-Owned-Enterprises and Organizations were established mainly in the public interest. I agree that the expansion of infrastructure in electricity by the Public Power Corporation, in telecommunications by Hellenic Telecommunications Organization, in rail transport by the Hellenic Railways Organization, etc., did facilitate economic development to take-off and become self-sustaining. To be sure, during this period elected governments in general and politicians in particular did not abstain from taking advantage of the attractive job opportunities that State-Owned-Enterprises and Organizations offered to place their supporters and thus enhance their stay in power. But either because the administrations they appointed resisted indiscrete political interferences, or because politicians exercised some restrain, or employees felt allegiance and solidarity with respect to the social responsibility of State-Owned-Enterprises and Organizations, excesses were avoided and social costs were kept reasonably low. But after 1974, the shield that the 1975 constitution provided to labour unions in conjunction with the extremely partisan politics that emerged, led to a reckless overmanning in SOEs, appreciable increase of their social costs and a parallel decline in the quality of their services. In short, as the behaviour of politicians became abusive, their employees gave precedent to their private interests, and the state became unable to modernize their installations through self-financed investments, the productivity of State-Owned-Enterprises and Organizations and hence their contribution to eco-

[21] For some quantitative indications regarding the adverse influences on the competitiveness of the industrial sector of the distortions in the labour markets, see Milas (1999).

nomic growth decreased, whereas in some of them services collapsed completely, after bilking taxpayers of tens of billions of Euros.

In difference to what happened in other advanced European countries, in Greece the activities of public utilities were not limited to those that have been traditionally included in the so-called "natural monopolies". For various reasons, public ownership and management was also extended to banks and special credit institutions and through them to broad sectors of the economy. The impacts of these policies were as expected. Prior to 1974, the banking system was dominated by the National Bank of Greece, the top management of which is appointed to the present day by the government. With coverage from the Bank of Greece and other relevant government authorities, this bank encouraged the undertaking of investments by providing low-interest loans and taking over businesses in industries such as insurance, hotels, manufacturing, construction, etc. This policy helped spur economic development, since government plans and decisions could be implemented without the usual delays of bureaucratic procedures. But through this policy, the National Bank of Greece merged and brought under its command powerful political, financial and business interests, in the core of which were embedded all the risks the positive results from its activities in the short-run to turn negative over the long hall. Unfortunately, after the two oil crises and the opening up of national economies to competition in the 1970s, it didn't take long for the structural weaknesses in the Greek economy to surface, which were worsened further particularly with the nationalization in 1976 of the two banks, Commercial bank of Greece and Ionian and Popular Bank of Greece, as well as the major industrial complexes they controlled in several key sectors. Thus, there formed a powerful conglomerate of indirectly public enterprises, some of which were from the beginning or became later problematic and shut down, whereas a few continue to operate under accumulating losses.

Finally, it would be an omission not to mention the negative effects of policies that were adopted after 1974 with the aim to upgrade the services of the so-called "welfare state". According to the results presented by Katrougalos, Lazaridis (2003), Liaropoulos, Tragakes (1998) and Matsaganis (2005), these policies failed because they reduced neither inequality, nor the various impediments to the access to public goods and services by poor people. But the cost of these policies to democracy and the economy was enormous, because they helped establish and diffuse to the whole society transaction mechanisms characterized by lack of transparency, impunity and extreme individualism.

2.2.2 Structural policies

Many researchers tend to classify structural economic policies into categories, depending on the sectors of the economy to which they apply. Based

on these classifications, the relevant literature refers to structural policies in agriculture (agricultural policy), in industry (industrial policy), in energy (energy policy), in communications (telecommunications policy), in the environment (environmental policy), in education (educational policy), etc. Our interest here is not to assess which structural policies were applied to particular sectors, for what purposes, or what were their results, since such an approach would be both unnecessary and impossible here. On the other hand, from what has happened to the Greek economy we know that, these policies were accompanied by catastrophic consequences mainly because they sought and achieved to replace the self-coordinating mechanisms of the market by procedures of central control. Therefore, I shall limit myself to some key examples.

The banking oligopoly

During the post war period, the monetary authorities sought and managed to eliminate competition from the financial system. Until late in the 1980s, the adopted policies were embedded in a centrally administered system of differential interest rates which aimed to direct the flows of investment to those sectors that the technocrats in the Bank of Greece considered growth enhancing. In order to apply credit policies through this system, commercial banks and special credit institutions were induced by various means to comply with a predetermined set of interest rates for loans and deposits. Two such means were, for example, on the one hand the incentives and disincentives in the mechanism of credit policies, and on the other the ability of monetary authorities to regulate certain key activities of credit institutions through the so-called "expediency permits". In our view, so wide and so permanent was the influence that these practices exerted that, despite their abolition in 1987, the oligopolistic structure they introduced in the banking sector has not changed much to the present day.[22]

To this result contributed also certain other supplementary policies. Initially one of them took the form of discouraging competition among banks through the threat of forced merger. For an example I note that Law 2282/1953:

- Granted an option to the Minister of Trade to call on the shareholders to assemble and decide on the merger of their banks (Article 1, paragraph 1 of Law 2292/1953).
- Differentiated the requirements for quorum and majority in the general assemblies of shareholders (Article 1, paragraph 3 of Law 2292/1953).

[22] For example, from the study of Hondroyiannis, Lolos, Papapetrou (1999) it follows that in the middle of the 1990s Greece's banking sector operated in a framework of oligopolistic competition.

- Provided the possibility of mandatory merger by decision of the Council of Ministers without prior decision of the shareholders of the banks concerned (Article 10, paragraph 1, Law 2292/1953), etc.

Later, with the provisions of Article 106 of the 1975 Constitution and the nationalization of the Commercial Bank of Greece and the Ionian and Popular b Bank of Greece, the threat to private banks that dared challenge the power of the Bank of Greece climbed to paralyzing heights. But after the accession of Greece into the EU in 1981, and even though command based structural policies continued for several years, the threat of forced mergers and nationalizations subsided and the banks searched for a new equilibrium, which led to the present banking oligopoly.

Finally, I suspect that the trend toward concentration in the financial sector was not unrelated with the views that prevailed among experts of Industrial Organization. Prior to the world financial crisis in 2008 their view was that, due to economies of scale, scope and/or network, there existed an inverse relationship between the size of banks and their long-term average cost curve, which justified mergers, in view also of the internationalization of economies. But more recently studies showed that the results of mergers are not encouraging because: (a) they do not improve the efficiency of merged banks; (b) weaken competition and reduce consumer's surplus,[23] and (c) big banks hold significant risks for the stability of the financial system. Hence, considering the great significance of competition, the Competition Committee can hardly become too vigilant.

Strategic industries and enterprises

As they were impressed by the successes of the Soviet Union, especially in the sector of heavy industry, many noted economists and politicians in the period 1930-1950 proposed the organization of Greece as a command society and economy. The prevailing view was initially that, in order to achieve rapid economic growth, the state ought to own and manage the large enterprises in all sectors of the economy. But over time, and as it became apparent that the state could not afford the burden of required investments, their vision narrowed and what they suggested was that the state ought to focus on those activities that were considered "strategic" in the sense that they contribute multiplicatively to all other sectors of the economy. In these sectors they included electricity, telecommunications, water supply, etc., and this explains why governments established in them SOEs. Above we saw what happened with the latter. They accumulated losses and debts, they were left behind technologically, and they distorted so much the incentives and the remuneration of workers in general that the

[23] See, for example, the papers by Athanasoglou, Brissimis (2004) and Rezitis (2010).

country's creditors asked and the Greek government committed presently to implement far reaching reforms, including privatizations.

Later the concept of the "strategic sector" was extended to include "strategic enterprises" as well. The suggestion for the state to invest in such enterprises was not new. But its time had not arrived yet. This happened in the early 1960s when conditions were ripe for the state and the banks it controlled to initiate it. In 1964 the Government took the lead in the establishment of the Greek Bank for Industrial Development, which became one of the largest investment banks in the country. Simultaneously, the National Bank of Greece started to acquire dominant stakes in financial and non-financial corporations, whereas the group of the Agricultural Bank of Greece at the end of 1999 comprised 17 companies, 8 of which were operating in the financial sector, 2 in the insurance industry and the remaining 7 in various other sectors. Parallely, the same bank had minority interests in 31 companies mainly in the processing of agricultural products. So, allowing for the investments of the National Investment Bank for Industrial Development, which was founded by the National Bank of Greece in 1963 and operated until 2002, I am led to the conclusion that the particular policy received widespread and prolonged application and the question is whether it proved successful or not.

Our view is that the results were negative. First, it should be noted that all banks which took part in this policy shut down or became problematic (e.g. Agricultural Bank of Greece). Second, from the companies in which the National Investment Bank for Industrial Development established majority or minority stakes, most went bankrupt, whereas the few that passed to private interests, when the bank itself was privatized in 2001, were in in dire economic situation.[24] Thirdly, the same fate had most, if not all, business concerns to which other state banks invested like, for example, Piraiki-Patraiki which, after operating for several years at the expense of taxpayers, eventually closed down in 1996, leaving debts of the order of 240 billion drachmas. The National Investment Bank for Industrial Development was perhaps the only investment bank which worked creatively, avoiding systematically to taking control or assuming the management of the industries in which it invested. But even in its case, the percentage of industries that survived was relatively small.

The usual explanation for the failure of the policy of "strategic sectors and enterprises" is that Greek banks proved incapable to implement it as effectively as, for example, Germans did. Those who adopt it are wrong for three reasons. First, in contrast to the European setting, by and large this policy was not chosen freely by state banks to serve their own business objectives. Second, because the managements of state banks were

[24] For example, the Skaramanga Shipyards were and remain problematic to the present day.

appointed usually by political criteria; and, thirdly, because in not too few cases the policy was implemented as if it was intended to cater to the interlocking relationships of political and business interests.

If some continue to believe in the merits of this policy, hopefully very few by now, it is useful for them to recall the disastrous turn its practice took after 1981. Then, the idea was launched that the state could take over the companies that had become problematic, due to the two oil crises and the march of international competition, restructure them and then return them to the private sector, thus preserving thousands of jobs which otherwise would have been lost. What happened we know precisely from the relevant literature and there is no need to repeat it here in detail. Of the nearly seventy companies that were placed under the Organization of Company Restructuring, the great-great majority were liquidated, some were privatized, whereas two or three continue to operate under state ownership and management at the expense of taxpayers, since each year they leave mountains of losses. Thus, the nice idea of preserving jobs via company restructuring by the state added several billion Euros to the public debt and taxpayers are forced now to repay through new sacrifices.

Protection of "infant industries"

The foundation and development of a new industry depends largely on two conditions. The first is the ability of the enterprises that enter to cope with the losses that occur usually in the first years of operation, whereas the second requires these enterprises to be able to withstand the competition from imports. Taken together what they imply is that these enterprises must be economically robust at that juncture in which they are young and feeble, that is infants. Drawing on these conceptualizations, many decades ago it was suggested, and still continues to be supported widely, that it is legitimate and effective on the part of the state to intervene and, inter alia, protect the “infant industries” from foreign competition.

The protection of “infant industries” in Greece took the form of tariff and non-tariff barriers to imports. In both cases the objective was the same. Namely, to keep the prices of foreign products higher than the prices of those produced locally, so as to provide the Greek infant enterprises with the time and the resources to gain shares in the domestic and international markets. Did this policy succeed? We know that it failed because, when the economy opened to international competition in the 1970s, there emerged a populous generation of problematic enterprises, most of which went bankrupt. Why did this happen? It happened mainly for two reasons. First, because the orientation of structural policies was to support productive activities that aimed at import substitution; and, second, because after the tariff and non-tariff barriers were imposed they became permanent.

Thus, as it happened elsewhere, experience in Greece ascertained that the imposition of barriers to imports is a pretext to protect non-competitive industries, the owners of which master and apply significant political influence on governments.

Saturated branches of industry and expediency permits

To direct the flows of investment towards activities they deemed growth enhancing, aside of those based on the credit terms mentioned above, the authorities employed a wide assortment of other policies. Two of them were applied very extensively. The first was the classification of certain industries as "saturated", in the sense that their installed capacity exceeded the demand for the products they produced. In these industries no further investments were permitted because they were considered wasteful. The second policy drew on a legally established prerogative whereby the authorities investigated in advance whether the proposed investment in a particular industry would be useful or not from a social point of view and accordingly they permitted or not its implementation. As was the case with the other structural policies, these too turned out to be highly distortive and not only because the authorities inhibited entry into the various industries and protected incumbents from potential completion.

In addition, these policies were exceedingly distortionary, because over time they were extended deep into the private sector. For example, the policy of "expediency permits", which was invented before the war to regulate competition in certain key sectors of the economy, in the post war period it was extended to numerous professional occupations. Certainly, this widening of its application was not adopted without benefits for the politicians and the professionals who cooperated. But the decline in the well-being of citizens as consumers of the services of these professions was significant and permanent because, due to the stifling of competition, prices have been kept above equilibrium up to the present. So it is not surprising that now the representatives of Greece's creditors are asking the government to open up all closed professions. The amazing thing is that, ignoring the dire situation of the country, the government resorts to various tricks to avoid the substantive opening of privileged professions like those of engineers, pharmacists, public notaries, etc. And all this while direct state interventions are known to have unintended consequences, the cost of which over the years exceeds many times the benefits they generate for the professional classes that they are enacted to favour. This explains why regulations should be introduced only if they increase actual and/or potential competition. If not, they should be avoided.

Price controls

Even in its relatively narrow space, the private sector could not operate freely in a framework of general rules. The reason is that until today governments found it frequently expedient to use direct price controls in various markets to achieve certain objectives. The following three examples suffice to clarify the nature and the extent of these interventions.

1. Price controls to influence the rate and distribution of investment. Drawing on the view that some forms of capital are more productive than others, governments intervened on the one hand to stimulate the rate of investment and on the other to steer its flows towards activities they believed would accelerate economic growth. They did so by introducing investor incentives and disincentives via the monetary or the fiscal channels.

Referring to the former, the incentives and disincentives monetary authorities instituted were embedded in a system of differentiated interest rates and quantities of loanable funds for investing in various sectors of the economy. Through this system interest rates and credit terms subsidized long-term industrial investment, while they discouraged investments in stocks of goods and raw materials, in commercial activities, in private houses, etc. So were they effectiveness? According to Halikias (1978, 210-239), who was in the best position to know, the hypothesis that favourable treatment would accelerate investment in industry was not vindicated. The reason being that industrial companies, instead of taking advantage of the favourable credit terms to boost their competitiveness, they chose to compete through credit advances to domestic commercial enterprises and flourish within the high walls of tariff protection. That is why the frequent references to the structural imbalances of the Greek economy are nothing else but convincing evidence to the effect that the selective credit controls that were applied in the post war period distorted heavily the structure of the Greek economy.[25]

Turning next to the fiscal channel, one big category of investment incentives and disincentives comprises policies like the provision of: (a) subsidies on the initial investment and/or the interest rate on borrowed funds implement the investment; (b) accelerated depreciation of plant and equipment; (c) tax-free reserves, (d) tax exemptions of profits for the first few years, etc. All of them are intended to work through changes in the user cost of capital. For example, a state grant on the investment reduces its cost to the potential investor and increases the return that he may expect to realize, thus motivating him to undertake it. However, from the voluminous empirical literature that exists on this subject it turns out that, the effect of such interventions is temporary because the deficits in public budgets force governments to renege on their commitments by introducing

[25] For an appraisal of the effectiveness of these fiscal measures, see Eisner (1969).

measures that increase the user cost of capital.[26] This behaviour has been particularly characteristic of Greek governments. So in all likelihood these policies did more harm than good to the Greek economy over the course of several decades.

Another equally big category comprises incentives and disincentives which are designed to influence the distribution of investments among various sectors of the economy as well as among various regions. These work by lowering the user cost of capital in the destinations where governments wish to encourage investments and raising it in those that they wish to discourage investments. In Greece there is empirical evidence which shows that such policies not only failed to achieve their intended results but also that they hurt the economy.

2. Price controls to redistribute income. Governments, for various reasons, hold the view that the observed distribution of income is not "socially fair" and intervene in the price mechanism so that it can lead to more desirable results in this regard. Examples of such interventions are the policies of: (a) the minimum wage; (b) rent control workers; (c) price supports of agricultural products, etc. In this case the question that arises is this: Do these policies in fact benefit the categories of income earners on behalf of whose they are enacted or perhaps they hurt them? The answer that emerges from the relevant empirical literature is predominantly that these policies hurt precisely those whom they purport to benefit.

3. Price controls to mitigate market failures. The structural policies mentioned above are based on the presumption that, when appropriately designed and implemented, markets yield more desirable results than when they are left on their own. Unlike them many other structural policies are adopted on account of, first, research findings that certain markets do not work as they should for the free market economy to yield its best results, and, second, the conviction that governments have the ability to intervene and act correctively. In the relevant bibliography it is argued that the market mechanism fails in the presence of: (a) concentration of monopoly power; (b) external economies or diseconomies; (c) asymmetries of information in the demand and/or the supply of goods and services, and d) the so-called free-rider's problem, which relates primarily to public goods. From the meticulous study of the structural policies that were adopted in Greece to improve the results of markets that fail due to one or more of the above imperfections, I have come to the conclusion that these policies hurt

[26] According to Gwartney, Hall, Lawson (2010,72) this very low ranking is due to the further tumble of Greece with respect to the criteria: (a) property rights protection, where from the 25th position in 1980, it fell down to the 50th in 2008; (b) freedom of commerce, mainly towards third countries, where from the 39th position in 1980, it tumbled to the 80th in 2008, and (c) state regulations in credit markets, labour markets, and enterprises, where from the72th position in 1980, it fell to the 90th in 2008.

more than they helped the economy because: (a) in general governments do not have the ability to bring about a better best outcome than markets, and b) Greek governments in particular have been notorious for their inefficiency in designing and implementing even simpler policies than the ones which would be required.

2.2.3 Assessment of economic policies

Fiscal policies before 1974 followed roughly the same footprints. Budgets left occasionally small deficits. But with the savings which flowed each year into the social security funds, the surplus in the public budgets, together with the seigniorage from the Bank of Greece and some limited borrowing, enabled governments to finance the necessary investments in infrastructure. After 1974, fiscal policies changed orientation. In particular, their emphasis was placed on raising public consumption. To finance social entitlements and the building of infrastructure, the surpluses of social security funds turned into deficits and the state begun to borrow initially from domestic sources. Then, with the interest rates rising and with the public deficits becoming ever larger, the socialist government which came to power in 1981 started to borrow heavily from abroad. As a result, the public debt accumulated fast and the interest outlays begun to widen the gap in the balance of payments, thus rendering the equilibrium of public finances eventually unsustainable. Such was the fiscal binge that it is worth noting this. When the country returned to decent economic growth in the period 1993-2008, the surpluses were not directed at repaying a part of the public debt, but together with the enormous financial assistance from the EU, they were devoted mainly to public consumption, of course with the complicity and much to the delight of all Greeks.

The last sentence foreshadows also our assessment of monetary policies. Experience leaves no room for leniency. With their choices the monetary authorities: (a) eliminated competition from the financial sector and distorted the distribution of capital among various sectors to such an extent that when the economy opened to international competition in 1980s, it was unable to adjust resiliently; (b) inspired and cooperated with governments to transfer resources from the private to the public sector in full knowledge that by doing so they impaired the growth potential of Greece; (c) failed to keep the rates of inflation in line with those in competitor countries so that after 1974 Greek products and services lost competitiveness in the international and domestic markets, which eventually led to the collapse of the trade balance and the balance of payments, and (d) did very little to forestall the impeding catastrophe, when the country entered the Eurozone with awesome structural distortions and macroeconomic imbalances.

Nowadays the vast majority of Greek citizens understand that the structural economic policies which were introduced, particularly after 1974, distorted the Greek economy to a great extent. Actually, as the distortions occurred while other countries accelerated the liberalization of their economies, Greece plummeted in the rankings of free market economies in the world. This we know from the report *Economic Freedom of the World* (2010), which reported that in the same year and on a worldwide basis Greece was in 60th position, i.e. way behind the other EU countries. But, as the press and the other media of mass communication continue to bombard them daily with the messages of the opponents of the open society and free market economy, Greeks are very confused. In particular, they are uncertain as to which structural policies can put Greece back on a high growth path and help regain its credibility as a nation.

All structural policies are by nature static and their implementation takes place through rigid bureaucratic mechanisms. Thus, as a rule, they are adapted to changing market conditions with significant lags. Suppose though that the authorities are able to design such policies with automatic feedback correction properties, so the usual delays vanish. Can we assume the same ability on their need to discount the reactions of individuals to changes in these policies? The answer is no because: (a) no one is able to know the response strategies of individuals ex-ante, i.e. before they occur, and (b) even if one were able to know, one would not be able to represent them uniquely. From these considerations one may be tempted to conclude that there is no logical basis in the conduct of structural economic policy. Such a conclusion would be unwarranted because we live in an imperfect world. So what needs to be done is to identify the nature of coherent structural policies and the limits that exist for intervention in markets which fail. Since the authorities are unable to have information on the strategic choices of individuals in an environment of constant change, I conclude that consistent are only those structural policies which reduce the imperfection of a market without increasing those of another.

2.3 Effects of globalization

During the period under review the Greek economy was exposed to two waves of globalization. The first begun from the signing in 1961 of the Association Agreement with the EU, whereas the second from the cataclysmic changes that took place in the early years of the 1970s. More specifically, in 1972, the dollar got loose from gold and the Bretton Woods system of fixed exchange rates was abandoned. In 1973 and again in 1979 we had the two petroleum crises. The sharp competition in low and high technology products from South Asian countries peaked in the 1980s; and of course from the 1990s there started to appear in international markets the products from Communist China. Due to these changes, the economies

of all countries open up and instead of seeking economic growth through import substitution in a closed economy setting, they started to adopt the growth model which is based on exports. Our objective here is to trace and assess the effects of globalization on the Greek economy.

2.3.1 Results from participating in the European integration

The nature and extent of the influences that the Greek economy received from the country's participation in the process of European integration, as well as their consequences, have been studied, both by domestic and foreign researchers. The presentation below is based largely on this literature in conjunction with the findings in Section 1.

1961-1981: Agreement of Association

The tariff regime that this agreement established was quite favourable for Greece. In particular, while Greek tariffs and quantitative restrictions on imports were marked for gradual reduction over a 12-year period, exports enjoyed the same tariffs with those in the six countries that comprised the EU at the time. The agreement created a gradually declining comparative advantage, which was designed to bring about two results. First, to give the Greek economy time to start growing through increased exports to the community, and hence with lesser constraints from the balance of payments, and, second, to adjust to the more competitive countries of the EU, and thus enable it to stand on its own in the face of the demanding conditions within the community. Were these two objectives achieved? Our view is that they were not and I base it on the following considerations.

Eichengreen (2007, 25) informs us that during the period 1950-1973 Greek exports to the EU and the rest of the world increased at average annual rates of 12.5% and 12.3%, respectively. Hence, the favourable impact other researchers found was probably due to the sample period of the data they used. This explanation is reinforced considerably from the research that Papantoniou (1979, 40) conducted with data covering the period 1967-1973 from the *Annual Industrial Surveys*, published by the National Statistical Service of Greece. Among other results, he found enough evidence to conclude that:

> "The EEC contributed about half of the total increase in manufactured exports. This combined with the fact that the share of EEC exports in total manufactured exports remained about half-47.1% in 1967 and 48.5% in 1973-implies that the rate of increase in exports outside the EEC was as high as the rate of increase in exports to the EEC."

Therefore, the results were not encouraging because, even though exports did shift from the world to the EU due to the preferential treatment given to Greek products in the EU markets, contrary to expectations, total exports did not increase.

However, his results also showed that the Agreement of Association was not utterly without favourable effects, since it helped the products of traditional industrial sectors to gain shares in the EU markets. In particular, he found that the growth rate of such exports to the EU was extremely high (65.2%) compared to modern consumer goods (43.6%), basic metals (5.6%), and mechanical and other products (29.6 %). Perhaps it is in this light that Georgakopoulos (2002, 2), more recently, arrived at the following assessment:

> "The country's association with the European Economic Community in the early 1960s, which allowed Greek exports of manufactured products to be treated in the same way as intra-community trade of the six original members of the community, but allowing for a lengthy period of adjustment of the Greek tariff to the EC common external tariff, was also an important contributing factor to the country's high growth over this period."

Drawing on the above, we ought to concede that, despite the difficulties its smooth application encountered, the Agreement of Association influenced favourably the Greek economy. Rather it did, but not by our standards for the following reason. When the usefulness of the association with the EU was discussed in the late 1950s, the aspect of interest was not if and by how much exports would increase. The main focus was whether through appropriate structural reforms the Greek economy could become strong enough to withstand the keen competition that prevailed within the EU. That this was the main issue there is no doubt, because here it is how Papandreou (1962, 25), ending the controversy and the recriminations, summed up the challenge Greece faced:

> "Greece has recently concluded an Association Agreement with the European Common Market with the prospect of full membership some 22 years hence. It is fair to say that, given the terms of the association, Greece has a small margin of time in which to achieve the structural transformations needed for survival in the European Common Market."

Consequently, the issue is whether Greece, in the window of 22 years that the Agreement of Association allowed, did introduce the necessary structural reforms. Unfortunately, while after 1960 Greek governments knew

full well that the main objective was to adjust the economy to the more competitive ones of the EEC, not only they did nothing, but they went even a step further. At all costs they: (a) kept alive failing enterprises; (b) mindlessly closed markets to actual and potential competition; (c) gave in to the cartelization of hundreds of professions, and (c) against all rational thinking, they increased the size of the public sector to such an extent that the problems Greece faces today became almost certain.

1981-2000: Agreement of Accession

In the late 1970s the economy was converging to the economies of the EU. Despite the slowdown in many macroeconomic aggregates, it was gaining ground in all areas and rather despite the reduction in tariffs under the Agreement of Association. This does not mean that there existed no problems. There existed and I pointed them out above. But these problems, while it is sure that they slowed down economic growth and ceteris paribus would have pushed the economy into prolonged recession under the changes that were taking place also in the international economic environment, from Tables 5 and 6 it turns out that their adverse influences were glossed over by the acceleration in productivity and in competitiveness relative to the EU. That is why the government which emerged from the elections of 1981 correctly negotiated a new adjustment period during which Greek tariffs towards EU countries would be reduced later and at a slow pace.[27] In practice, however, neither this new transition period nor the huge financial assistance, which began to flow from various EEC Structural Funds, proved sufficient to stem the undesirable developments that followed.

In Section 1 we saw that economic growth, productivity, competitiveness and many other key metrics of the economy deteriorated significantly after 1981. For example, referring to the impact on exports from the accession to the EU, Table 7 shows how two main components of the balance of payments evolved. While until 1980 the surplus in the balance of services was rising, afterwards it followed a downward trend, which continues to the present day. At the same time, albeit with some lag, the balance of trade started from 1990 to deteriorate, so ever since the deficit in the balance of current transactions widened.

In view of these developments, many researchers tried to detect the direction and severity of the effects that the accession to the EU exerted on the Greek economy. For example, Georgakopoulos, Paschos (1985), Georgakopoulos (1988), Demoussis, Sarris (1988) and Baltas (1997) explored the effects in the agricultural sector. Katsoulakos, Tsoumis (2002) turned

[27] The process of tariff reduction at the level of EU is described briefly by Tsaveas (2002, 332).

Πίνακας 7: Εξέλιξη του εμπορικού ισοζυγίου,
δις. Ευρώ, σταθερές τιμές 2000

	1961 -70	1971 -80	1981 -90	1991 -00	2001 -10
1. Εισαγωγές αγαθών	4,21	9,82	16,08	28,53	46,59
2. Εξαγωγές αγαθών	1,33	4,83	9,08	11,80	16,00
(2):(1)	**0,32**	**0,47**	**0,56**	**0,41**	**0,34**
1. Εισαγωγές υπηρεσιών	0,54	1,36	2,44	5,26	11,21
2. Εξαγωγές υπηρεσιών	1,19	3,71	5,43	10,53	21,20
(2):(1)	**2,20**	**2,73**	**2,23**	**2,00**	**1,89**
1. Εισαγ. αγαθών & υπηρεσιών.	4,75	11,18	18,52	33,79	57,81
2. Εξαγ. αγαθών & υπηρεσιών	2,53	8,54	14,51	22,33	37,20
(2):(1)	**0,52**	**0,76**	**0,78**	**0,66**	**0,64**

their attention to the industry, whereas Georgakopoulos (1993) and Oltheten, Pinteris, Sougiannis (2003) assessed the overall impact. The main conclusions from this literature are as follows:

- Despite the twenty year of preparatory period, in 1981 the Greek economy was unprepared to join and progress in the competitive environment of the EU. Private enterprises in all sectors survived thanks to the high tariff protection and considerable subsidies. The markets were regulated centrally by administrative controls, stifling competition and reducing the flexibility of the economy to adjust to domestic and external shocks. The narrow public sector was over-sized and operated as inefficiently as presently, whereas the broader public sector was dominated by powerful labour unions, often holding the government and the citizens hostage. In general, in the late 1980s the structure of the Greek economy was further than the model envisioned in the Treaty of Rome than it was in 1960.
- Under the Common Agricultural Policy (CAP) the lower prices of Greek agricultural products reached parity with the higher ones in the EU. As a result, this development: (a) reduced the competitiveness of Greek farm products relative to those of the community, (b) slowed exports, (c) increased farmers' incomes, and (d) quashed farmers' incentives to increase productivity so as to preserve some

measure of competitive advantage.[28]

- The rise in farmers' incomes, due to the CAP, as well as in the incomes of other social classes, due to the generous assistance from the EU, increased the aggregate demand in the economy, accelerated imports, and destabilized the balance of current transactions (See last row of Table 7 above).
- As expected, to address the widening gap in the balance of current transactions, governments resorted to successive devaluations of the national currency. These, while on the one hand stimulated inflation, on the other became increasingly ineffective because they failed to increase the competitiveness of the economy, since the demand for imports was fuelled by the EU aid and the reduction in the propensity to save.[29]
- EU assistance was not used effectively. For example, subsidies to farmers aimed at supporting their income and not to reduce their production costs. Investments to restructure crops, increase the size of farm lots, improve farm organization and management, etc., were neglected. In other words, the warning by Georgakopoulos (1988, 138) that the offsetting of the costs of accession would depend on the use of EU assistance was ignored.
- Due to the EU Single Market Programme many researchers expected that the gradual reduction in tariffs as well as the high differential inflation would reduce the competitiveness of industrial products and lead to a serious shrinkage of industry. Table 3 shows that in terms of gross value added this expectation did not materialize. By contrast, as shown in Tables 5 and 6, despite the adverse macroeconomic environment, the bulk of the industry survived because it managed to remain competitive.

From the above it follows that the accession of Greece to full membership in the EU was accompanied by high costs because governments: (a) left the Greek economy institutionally and structurally unprepared to face successfully the challenges to which it was exposed, and (b) failed to make effective use of the generous EU aid, since they channelled it more to consumption than investment.[30]

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[28] Mamatzakis (2003) has found that the decline of productivity in the agricultural sector emanated also from the significant reduction of public investments in agricultural infrastructure.

[29] Various studies like, for example, the ones by Brissimis, Leventakis (1989) and Paleologos (1993), have confirmed that the devaluations of the national currency in the 1980s did not improve the balance of payments. In the short run, devaluations had some small positive effects, but over the long haul the competitiveness of the Greek product and services returned to the pre devaluation level.

[30] EU aid was not wasted only in the agricultural sector. The same happened with the aid that was spent to improve human capital. In particular, a large part of the financial as-

2001–to date: Accession to the Economic and Monetary Union

In 1992 the countries which participated in the EU decided to proceed to the next phase of the European integration and for this purpose they adopted the criteria of the Maastricht Treaty. As several of the countries did not meet one or more of these criteria, their governments took steps to converge. So when in 1999 they decided which countries had achieved adequate convergence and would be included in the Economic and Monetary Union (EMU), Greece was found unprepared, whereas the United Kingdom and Denmark chose not to participate.

The blocking of Greece from the EMU made it clear that, for reasons having to do with the organization of its economy and its preparedness to introduce the necessary structural changes, it did not qualify. But the decision left the window open for Greece to enter later, that is after it managed to meet the Maastricht criteria. Figure 5 shows that in critical years 1999-2000 the budget deficit as a percentage of GDP fell significantly below 3%. From the same figure we observe that, although very high, the budget deficit from 1994 on slowed. As a result the public debt, which was much higher than the Maastricht limit, started to decline. Furthermore, Table 6 shows that inflation during these years was around 3%. Then, on account of these achievements and the fact that economic growth in Greece was almost double the EU average, the authorities justifiably decided to accept Greece into the EMU from January 2001.

However, the improvement in the macroeconomic imbalances, which enabled Greece's to enter into the EMU, were short lived because it was solely based on macroeconomic adjustments and left the structure of the economy unchanged. The prime ministers who served after 2001 understood the urgency of structural reforms and in their speeches expressed repeatedly their resolve to take bold action. But to no avail. For reasons of short-sighted political expediency they forgot their commitments, their governments adopted structural policies which worsened the functioning of institutions and markets, and soon after the celebrated entry of Greece into the EMU the deficits and the macroeconomic imbalances became uncontrollable. Thus, deprived in the Eurozone of the ability to deal with

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sistance was directed to further education and training of unemployed. These expenditures in essence were nothing more than income supports for the unemployed, the educators and those who initiated and coordinated the training programs. Unfortunately, according to research by Rodokanakis (2010), which focused in the area of Attica and covered the period 1990-1995, the resources that were devoted to these activities raised consumption, without improving the productivity of labour and without enhancing the productive capabilities of unemployed. Even worse is the finding by Katsoulakos, Strogylopoulos, Kritsalis (1996) that Greece failed to use adequately and effectively the aid which was earmarked for Research and Development (R&D).

external imbalances through currency devaluation, inevitably Greece arrived on the brink of bankruptcy.[31]

2.3.2 Assessment in regard to globalization

In view of the spectacular reversal of economic growth in Greece, some economists may think that this happened because before 1974 the economy was nearly closed, whereas after its accession to full membership in the EU in 1981 it opened to international competition. But we know that during the decade 1974-1984, tariffs did not decrease and yet on average all crucial indicators deteriorated. Therefore our view is that the setback was due primarily, if not exclusively, in three groups of other factors. The first and most significantly of them has to do with anti-economic growth bend that institutions took after the adoption of the 1975 Constitution. The second is associated with malignancies that took hold in the domain of the public administration and the wider public sector; and, finally, the third group of negative factors relates to the economic policies that were implemented. More specifically, regarding the failure of the institutions and the public administration, our view is that, even if economic policies did not worsened after 1974, Had Greece not integrated fully into the EU, the reversal would have occurred even earlier that it did.

3. Overall assessment

From the first section it follows that prior to 1974 Greece achieved: high economic growth rates (≈ 7%), enviable price stability (<2.5%), which enhanced the international competitiveness of Greek products and services and maintained the balance of payments under manageable control, enviable reduction of unemployment (<2.5%), improvement and expansion of social services, and all with very limited public debt (<12.5% of GDP in 1974). After 1974, economic growth fell to about one third (≈ 2,4%), the unemployment rate, which more than doubled in the period 1980-2000 (≈ 6%), in the decade of 2000 nearly quadrupled (≈ 9%), the explosive deficits in the balance Payment were contained only thanks to the huge EU aid, and the budget deficits pushed public debt to an unsustainable ratio (≈ 150% of the GDP in 2011). So now Greece is under the supervision and tutelage of its creditors. Due to this this extraordinary setback, I raised and attempted to answer the following question: What did happen and Greece, from the phase of spectacular economic expansion before 1974, regressed afterwards and now stands on the verge of bankruptcy?

Prior to 1974 the political and social climate was friendly to entrepreneurship, domestic and foreign. The public administration was signifi-

[31] Bitros (1992) and Bitros, Korres (2002) had warned well in advance what would be the awful predicament, if governments failed to introduce the necessary structural reforms.

cantly dysfunctional, but as it was organized hierarchically it had limited excuses to delay decision making and built corrupt relationships with the citizens. Fiscal policies, although oriented towards public consumption, covered adequately the needs for public infrastructure. Monetary policies aimed at price stability, whereas the inefficiencies that stemmed from the highly distortionary credit policies were subdued. As a result, at least the institutions and the macroeconomic policies were friendly towards economic growth and contributed results which offset by far the adverse effects from the public administration and the distortions of microeconomic or structural policies.

After 1974 the social sentiment became inhospitable, if not utterly hostile, towards business. In the first place, responsible for this turnaround were certain key policies enacted by the government which took over from the military regime. Exemplary among them are: (a) the drafting and the authorization of a new constitution in 1975, which opened widely the doors to socialism; (b) several nationalizations of big banks and large enterprises, and (c) numerous structural reforms, which signalled the establishment of a centrally administered and controlled economy. As these were inspired by a supposedly conservative government, they were perceived by business people as "regime change" and they started to act analogously. In the second place, regime change was all advocated by the socialist party, who leader and main protagonists lost no opportunity to reiterate that their intentions were to install a socialist regime of the "third road". Unfortunately, under the neo-socialist governments after 1974, democracy in form and substance was replaced by party politics. With the reforms that the socialists introduced in 1985, the civil service was deconstructed and corruption in the public sector became rampant. Fiscal policies were oriented mainly towards public consumption at the expense of investment in infrastructure. Total and private investment as percentages of GDP went into a long term downward trend. Foreign companies began to leave Greece and Greek companies to relocate in neighbouring countries; and in general Greece's decline followed the path that I described in the figures and the tables in Section 1. In short, after 1974, all institutions and macroeconomic policies, which previously favoured economic growth, reversed, whereas the public administration and the structural policies, which hitherto inhibited economic growth, were reinforced by party politics. If on top of the above we reckon that after 1974, and especially after 1981, governments did nothing to prepare the country for survival within the competitive environment of the EU, Greece's decline was all but certain.

In my view, the path to the current crisis started long before 1974. In particular, it began in the early 1950s, when the authorities decided to pursue the model of economic development with import substitution. Because

of this choice, except of maritime and tourism, in which entrepreneurs by necessity had to struggle in international markets to gain shares, the ambitions, the plans and the prospects of Greek entrepreneurs were confined in the narrow markets of the Greek economy. From this remark it follows that the model of development which was adopted nurtured over time entrepreneurs with claustrophobic and defensive reflexes and with deep dependencies from the political system and the state banks. Unlike Greece, so different countries like e.g. Germany, Taiwan, Singapore and South Korea found their way to high and sustainable economic growth in the post war period by adopting growth models based on exports. What would have happened if Greece had followed their example? Then Greek entrepreneurs would have become outward looking and the performance of Greek enterprises would not be limited by the small scale of the Greek markets. The model which would have been established would be that of the open and competitive economy and no government would dare distort it with mindless interventions. But, for the reasons that I mentioned in Section 2.1 above, there prevailed the ideas and policy recommendations of the supporters of the centrally administered society and economy. So entrepreneurs were subjugated to governmental objectives and operations. I am convinced that this explains why the economic policies before 1974, which in order to continue to contribute to economic growth had to be revised so as to conform to the open economy model that emerged, remained in full force. For if they had been revised in this direction, the revisions would have contradicted the agendas of the two major political parties, which aimed at capturing the democracy and the state and using the power of their authority to the benefit of the party nomenclatures completely unchallenged.

In closing I wish to stress that it is only now, i.e. after having spent considerable amount of time to study the post war economic history, that I realized that my recommendations, on how Greece might have avoided its present predicament, were all in vain. For example, in the light of the two oil crises in the 1970s, the rising inflation and interest rates, etc., in numerous articles and public speeches I recommended that it was high time for the governments to introduce deep structural reforms. What did I propose? I proposed that the number of civil servant and the operating cost of the narrow public sector ought to be reduced significantly. Through extensive privatizations public enterprises ought to be transferred to the private sector or at least be exposed to competition. In network industries such as electricity, telecommunications, transport, etc., governments ought to limit the injurious influences of labour unions and promote the technological modernization of public enterprises through self-financing, etc. etc. In retrospect I recognize that I was naive, because I did not know the true agenda of those who governed Greece in the post war period. I learned of it

only more recently when I came to realize that the 1975 constitution was based on the constitution that had be drafted in 1944 by the high priests of the Hellenic Socialist Union, most of whom played key governments roles. The tragedy that befell on Greece did not happen fatefully. It was made artificially fateful by the sortsighted and self-interested choices of neo-socialists politicians and intellectuals who shared the view that the market economy is not conformable with democracy. Now that Greece succumbed to the supervision and guardianship of its creditors, perhaps they may repent and open their eyes to the truth of the theorem that democracy without a free market economy is impossible.

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