Vikings in Greece: Kleptocratic Interest Groups in a Closed, Rent-Seeking Economy

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Last December, downtown Athens experienced three nights of street battles, arson, and looting that became headlines in the international press. We argue that the reasons for this extreme social turbulence are related to the regulatory and institutional rigidities that still prevail in Greece's economy, despite the strong growth that it enjoyed until recently. Furthermore, we describe the pattern of state intervention, institutional sclerosis, and high administrative costs that secure and allocate "rents" to interest groups that obstruct all efforts to reduce these rents and to open up the economy.[1]

In particular, we argue that these numerous rent-seeking groups curtail competition in the product and services markets, increase red tape and administrative burdens, and actively seek to establish opacity in all administrative and legal processes in order to form an environment in which they will be able to increase the rents they extract. At the same time, they actively stride to ensure that the rule of law fails to such an extent that the society will not be able to hold them

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[1]By "rents," we mean the payments above opportunity costs that accrue to special interest groups who seek favors from government. Rent seeking is an unproductive use of resources that lead to deadweight losses rather than to wealth creation (see Tullock 1993).

accountable for their actions. We finally argue that certain salient aspects of the design of the Greek political system suggest why Greek politicians are unable to champion reforms and effectively confront the designs of these predatory interest groups.

The design of an effective strategy that may initiate an unravelling of events that can lead to the construction of strong institutions and that will improve the quality of governance in Greece also requires a clear understanding of both the factors that have driven the strong growth of the past years as well as the causes that lead to what can broadly be described as the widespread failing of institutions in Greece today. Both of these factors shape the stakes of those who gain from perpetrating the status quo, which forms an environment that obstructs progress and that steadily excludes those who are not well connected with the interest groups from participating in economic and social activities.

The Paradox of Strong Growth with Weak Institutions

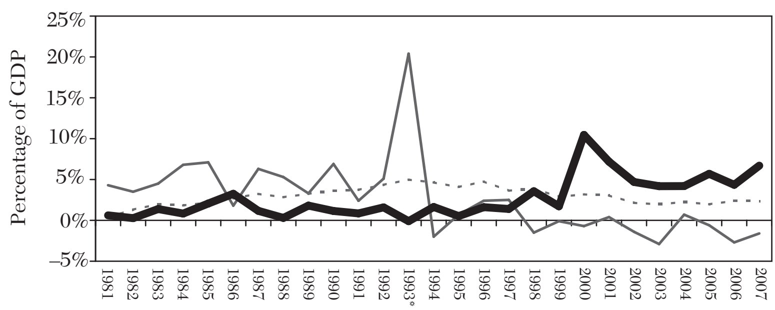
The OECD (2007) attributes the strong growth performance of Greece— according to Eurostat, average annual growth of real GDP of 3.8 percent from 1996 to 2008, with the lowest annual growth being 2.4 percent in 1996—to the following factors:

- The liberalization of the credit markets during the 1990s coupled with entry to the European Monetary Union (EMU), which led to macroeconomic stabilization and a steady increase of private credit after 2000.
- The deregulation of telecommunications and certain product markets, which had been heavily regulated, even though regulation in Greece still remains very high compared to other OECD countries (Conway and Nicoletti 2006).
- The growth of the shipping and tourism industries, which helped increase domestic demand and mitigate the huge trade deficit.
- The fiscal stimulus from the 2004 Olympic Games, which led to the improvement of certain key infrastructure facilities.
- The inflow of funds from the European Union, within the context of the EU structural funds and the Common Agricultural

Policy, which also led to key productivity enhancing infrastructure facilities.[2]

Figure 1 shows the size of the net inflows from EU funds and the expansion of private credit, both expressed as a percentage of GDP, from 1981 to 2007. It also shows how private credit replaced government deficit spending after 1997 as the main way to finance the expansion of consumption in Greece. These developments played an important role in promoting Greece's prolonged period of economic growth. Therefore, the inclusion of this data is appropriate and necessary in order to obtain the most useful conclusions from an analysis of the macroeconomic developments of the country. It also should be noted that repeated revisions of the data on the actual size of the General Government budget deficit could mean that ultimately there was no fiscal retraction after 2000.

FIGURE 1
Demand Injections in Greece, 1981–2007
(Percentage of GDP)



Change in General Government debt. * In 1993 all guarantees issued by the Goveernment that had been claimed in previous years were added to the public debt.

Net inflows from the E.U. funds.

Change in net credit issued by the private banking sector to enterprises and housholds. Change in the stock of financing over the year.

Sources: Bank of Greece, Ministry of Finance and Economy, European Commission Budget, and Eurostat.

[2]These funds stem from the contributions the governments of EU member states make to the EU budget and are disbursed by national governments according to rules set by the EU decisionmaking bodies.

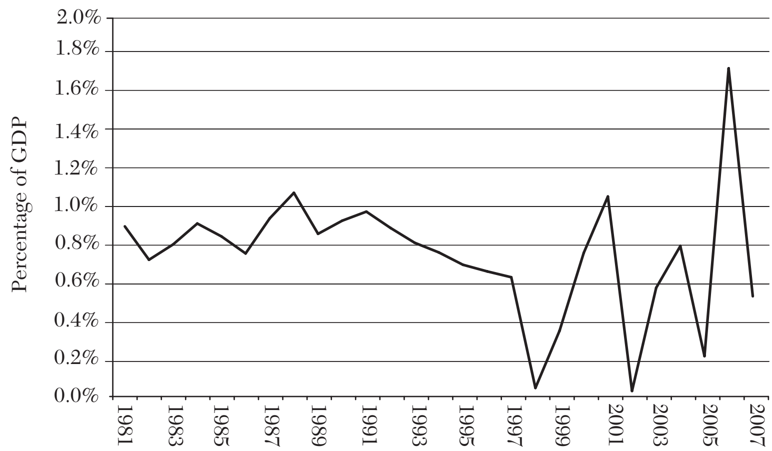
The rapid increase of new investment depicted in Figure 2 demonstrates the impact of the surge in investment that was largely encouraged and financed by the EU structural funds. The fact that a significant part of the increase in investment follows from infrastructure projects is not incompatible with the fact the information and communication technology (ICT) share of the total investment in Greece is one of the lowest in the OECD. As a matter of fact, the rush into EU financed infrastructure investment was matched by an acceleration of private investment mainly in those sectors that enjoyed deregulation, especially in the growth sectors of banking and telecommunications.

Despite Greece's impressive growth performance, the economy still suffers from four serious structural weaknesses: (1) the inflation differential with the euro- zone; (2) the persistent and widening large trade deficit; (3) the low level of competitiveness relative to other members of the OECD and the eurozone; and (4) the relatively low level of foreign direct investment (FDI) inflows.

FIGURE 2
Investment as a Percentage of GDP in Greece and the Eurozone

Source: Eurostat.

FIGURE 3
Direct Investment In Greece (FDI Inward)

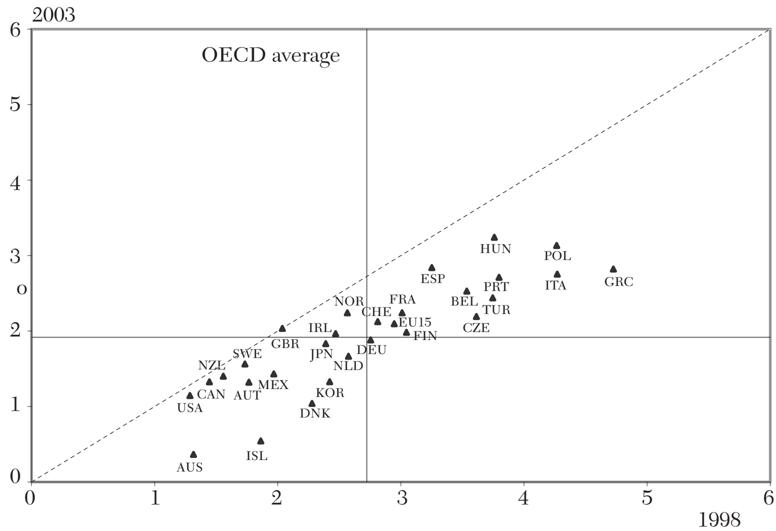


Source: UNCTAD Globstat FDI Database.

The inflation differential affects both tradable and nontradable goods and services. Thus, a plausible explanation of the differential is that, in the wake of the significant inflows from the EU and the rapid credit expansion, the Greek economy has remained relatively weak in terms of competitiveness. The combination of high demand growth paired with no matching increase in the competitiveness of a still tightly regulated economy has also led to a widening trade deficit: from 12 percent of GDP before Greece's eurozone accession to 17 percent in recent years. Also, according to Figure 3, FDI inflows as a percentage of GDP are very low for almost all years, in line with the established link between the attractiveness of the business environment and FDI (see Hajkova et al. 2007).

The compelling case for the low competitiveness of the Greek economy is documented by a number of surveys such as the OECD Regulation Database, the World Economic Forum Competitiveness Survey, and the World Bank Doing Business and Governance Indicators. In addition, the European Commission (2006) estimates that in Greece the administrative burden is exceptionally high, around 6.8 percent of GDP compared with 3.5 percent in the EU-25. Patterson, Fink, and Ogus (2003) find that the regulation of professional services is high with regard to entry and price setting and that qualitative standards are excessively lax. Likewise, the World Bank, in its *Doing Business 2009* report, ranks Greece at the bottom of eurozone members in terms of its business environment. A good depiction of the regulatory and institutional rigidities in Greece's economy is provided by the OECD Structural Indicators Database for the year 2003, as unfortunately Greece is one of the few countries that have not provided updates for the year 2007. The methodology used and first described in Conway, Janod, and Nicoletti (1998) reveals the pattern of widespread state intervention in the decisions made by companies regarding resource allocation and pricing, high administrative costs, and low regulatory quality. As is shown in Figure 4, although Greece made some progress in deregulating

FIGURE 4
Restrictiveness of Regulation
Having an Impact on Economic Behavior
(Index: 0 to 6, from Least to Most Restrictive)



Note: Economic regulation includes all domestic regulatory provisions affecting private governance and product market competition such as state control and legal barriers to entry in competitive market.
Source: OECD (2005).

product markets since 1998, it remained in 2003 among those OECD countries that still heavily regulated its product markets and the daily decisions of companies. Not surprisingly, Conway et al. (2006) found Greece to be the OECD country that had the most to gain in terms of private sector productivity by increasing competition in product markets.

Kaufmann, Kray, and Mastruzzi (2005) provide evidence, beyond product market regulation and the business environment, regarding weak institutions and poor governance, while Ackerman (2006) suggests how all these facts can be linked with the relatively high levels of corruption that are documented in Greece. The unattractive business environment documented by the World Bank and the highly regulated product markets documented by the OECD, which are linked with the low competitiveness of the Greek economy, emerge therefore as only one part of a more comprehensive pattern of weak institutions and weak governance.

The proliferation of red tape, the excessive regulation of markets, the government interventions that limit competition and resource allocation as well as pricing decisions in crucial network industries all contribute to the creation of rents. The case of Greece is unique among the other countries in the sense that it has combined factors that have contributed to the strong economic performance of the past years while maintaining such significant rents. Furthermore, the rapid growth of the past years has made the extraction of rents even more lucrative in this environment of weak institutions and weak governance. As credit growth and EU inflows financed consumption, the predatory behavior of aggressive rent-seeking groups has not led to the expected decline of the prosperity of an economy that raises massive obstacles to any effort to lawfully produce something. This fact may ultimately explain also why the interest groups did not aim to obstruct the reforms that were promoted in the credit markets as well as EMU accession. This pattern can also explain the success of Greece's tourism and shipping industries, which are less affected by the regulatory environment than other sectors. In the case of shipping, it operates almost completely outside Greek jurisdiction; while tourism benefits from the geographical attractiveness and the cultural heritage of Greece.

Finally, the momentum of the growth of the economy paired with the necessity to implement EU directives has also led, after many difficulties, to the ability to occasionally override such opposition, as has been the case for the telecommunications market. In the end though, product market rigidities and labor market distortions still complement each other in Greece today, reducing competition along a wide array of economic activities and creating sufficient rents to keep satisfying numerous interest groups.

We can describe Greece as a benchmark country that managed to achieve rapid growth because it took some steps in the right direction, but that still needs to deal with significant challenges regarding the quality of its institutions and governance if it wants to consolidate the gains of the past and achieve long-term growth. This picture fits well with the example of other countries that manage to initiate growth but not to complete their transition toward the group of developed countries (see Rodrik 2007).

The Design of the Greek Political System, Rent Seeking,and the Blockage of Reforms

We proceed now to demonstrate how the design of the Greek political system has led to rent seeking and the blockage of reforms. In essence, reform-minded politicians who threaten the status quo are easily removed from the political scene while politicians who cooperate with special interest groups are rewarded with long lasting political careers and immunity from almost any unlawful act they may engage in.

Description of the Players of the Game

Mandate holders, lawmakers, bureaucrats, mandate-issuing voters, and interest groups that include the media form some of the key players in the reality of Greek politics and the Greek economy. Each of these groups plays a specific role in the power game of Greek politics and economics, which results in the defense of the status quo against any reforms.

In this context, it is important to understand that the anomalies and rigidities in Greece's economy have their roots in half-closed markets, including the political market. Five elements can be highlighted:

1. Special interest groups that defend the status quo and seek to gain benefits ("rents") through political channels.

2. The role of misinformation of the rationally uninformed voter in a system that shuns transparency.
3. The role of the media as an information broker that can determine a crucial role in directing the dissatisfaction of the voters and that has the capacity to make voters understand the contribution of reforms, but that is itself a victim of blackmail from the constellation of interest groups.
4. The administrative insufficiency of the state as far as the establishment of the rule of law is concerned.
5. The failure of the mandate-holding politician as a lawmaker.

Powerful, Kleptocratic Interest Groups as Rent-Seeking "Vikings" in Greece

In Greece today there are numerous groups that act like the Vikings, in the sense that they grab anything they can while roaming freely through various aspects of social and economic activity. At the same time, the existence of pools of rent is widespread throughout the economy as a result of government regulations that aim specifically to create such rents by obstructing competition, but also by reducing transparency and accountability in the management of public funds in a way that allows the proliferation of rent seeking. Many small, well-organized groups—ranging from notaries public, lawyers, and truckers to less well-known cases such as loaders and unloaders in ports and public markets as well as trade unionists in publicly owned enterprises—earn significant rents, and therefore have a strong motive to maintain the status quo and oppose any reforms that could lead to the removal of these rents. These groups draw a significant advantage from their small size. They do not contain free riders that could undermine the group's agenda or fail to contribute actively toward it. These groups exhaust most of their available time and power to defend their privileges of a comfortable income that does not require them to work. They promote legislation that will favor them and constantly seek new opportunities that could increase their rents. In this effort, they rationally invest time and money to influence policymakers and the administration.

These groups are not stationary with a clear position in the system, like lobbying groups. Rather, they are usually formations and alliances of smaller groups that occasionally merge unofficially whenever their interests are aligned in the search for new rents or the defence of existing rents. It is this peculiar attribute that allows them to gain from the benefits of small size and the absence of free riders but to have the clout that the larger constellations of these groups can muster whenever any reforms must be resisted. They also immediately form loose but strong alliances with other groups whenever any pool of rent is threatened by a reform. They realize that the groups whose rent they defend today will also rush to support them as soon as their pool of rent is threatened by another reform-minded politician or by EU legislation. In this process, these groups take full advantage of both the lack of checks in the system, which would allow the interested general public to object to such a raid, and the lack of transparency. The absolute joining of the executive and legislative branches in Greek politics has been installed in order to remove any checks and balances from the system. Meanwhile, the lack of transparency is evident from the absence of any published minutes of the parliamentary committees or of court decisions.

In this setting, the acquisition of rents occurs whenever legislation is passed that restricts competition and gives privileged access to the beneficiary interest group. It should be noted, however, that rents may also be illegally obtained, given the lack of a transparent rule of law and the slow—and sometimes corrupt—judicial process (Mitsopoulos and Pelagidis 2007b). In these cases of illegal activity the rent is obtained through suffocating blackmailing of the lawmakers and the executive and a blunt horse trading with the administration that fits the pattern described by Tullock (2005) and that takes as given the fact that nobody will ever report the breaking of the law or, in the rare case that this happens, no effective punishment or remedy will be enforced.

Rationally Ignorant and Misinformed Voters

The modern Greek political system does not favor public debate. Rather, mandate holders favor the status quo, which is secured as long as they are held accountable by the strategically placed interest groups that blackmail and unofficially control them. This control is necessary to maintain the status quo because in Greece the mandate holders have the power to promote any legislative and executive initiative without any checks and balances (Mitsopoulos 2007).

In theory, it would be very easy to pass any reform and then to impose legislation that reintroduces sufficient checks and balances. The only thing that secures that this does not happen is the entanglement of the politicians in a powerful web of special interests that threatens to end his political career as soon as there is any indication that he favors such reforms. As a result, these groups do succeed in creating rents and ensuring that legislation passes that benefits members of the favored groups at the expense of outsiders and the general public. The losers are usually large but unorganized groups like unemployed workers, low wage earners, consumers, honest taxpayers, parents of schoolchildren, and entrepreneurs who simply want to do their job well and legally. A necessary precondition for the transfer of these rents to special interest groups is the lack of transparency. Hence, there is an effort to suppress the publication of the problems faced by the general public as a result of these activities. This is especially true with regard to the significant level of income inequality resulting from these large transfers.

According to Caplan (2007), voters generally are not well informed. This is particularly true in Greece because of the complexity and opacity of the horse-trading game in Greek politics and the high cost to citizens of interacting with the administration. It also follows because casting a simple vote, which allocates both legislative and executive power to a mandate holder who essentially governs unchecked until the next election, does not allow voters to express their preferences. Instead, they cast their votes on a broad bundle of propositions that fail to reflect smaller differences between candidates. Given the lack of the possibility for voters to express their opinions on such differences, they have little incentive to engage in a costly and futile process to inform themselves.

The Role of the Media as an Obstacle to Reform

In this setting the media, which operate in an opaque and unchecked legal and institutional framework, actively engage in a game of misinformation of the voters. Effectively, the media take advantage of the high cost of documenting and publicizing any misinformation, and they trade their ability to guide the opinion of the uninformed public in exchange for favors they receive from the executive, legislature, and administration. Given that this ability to determine the opinion voters form could also be used to inform the public about the necessity and the benefits of effective reforms, the participation of the media in the constellation of interest groups that interact with the branches of government emerges as a crucial point in the effort to explain the inability of the Greek society to promote these reforms.

In the hypothetical case of the Coase Theorem, where it would be possible to inform voters costless without any intermediary, the media would not exist. In the real world the media gain significantly value as they are the medium to contact and inform the voter, and this value is negatively related with the level of information the voters have, regardless of the information they receive from the media. According to Tullock (1993) the role of the media is especially critical in the effort of politicians to inform (or misinform) the voter groups that they target, and as a result the level of competition in the market for media is crucial in this case. To the extent that the players in the media market are few, as is the case in dictatorships, this level of competition is largely reduced, even if the modern technology makes it more difficult to establish such media monopolies.

In modern democracies, competition in the media is ensured by the existence of groups with different interests and the low cost of transmitting information. In such a setting, the decision of a politician to misinform voters is more likely to backfire. In contrast, when the media are collaborating with interest groups and politicians to misinform the public, it will be easier for politicians to play the rent-seeing game.

The design of the political system in Greece favors the emergence of uninformed voters. Indeed, the systematic removal of accountability and transparency from the activities of the legislature, executive, and judiciary strengthen the ability of the media to an unprecedented extent. As a result, it is predictable that the activity of these interest groups on the political establishment will led to the entanglement of the media in a weak and distortive framework that ensures that the media are themselves victims of blackmail from the political system, and indirectly from the interest groups.

The deliberate existence of a vague legal framework for media groups, which condemns them to effectively operate illegally, together with their dependence on government funds give the media an incentive to cooperate with the interest groups. Therefore, the media emerge as a critical obstacle to reforms—instead of using their potential to inform the public about the necessity and benefits of reform. The media will ensure that any politician who wants to introduce reforms that threaten the various pools of rent that the interest groups benefit from will quickly end.

The Administration as a Prize for the Interest Groups

The government and the administration are supposed to have the monopoly of setting the rules to form and validate contracts between the agents of the society, which are agreed on between them in a framework of free and competitive markets, according to the traditional neoclassical approach. The state, according to the Chicago school, and public choice, is a medium to maximize the income and interests of the most powerful groups. According to this view, the state and its mechanisms are aligned to serve the interests of each government, and the broad group of private individuals that act within its context in order to maximize their interests. It is possible that the state is simply the sum of individual bureaucrats who seek to maximize their utility by increasing the size of their budgets (see Niskanen 1971).

Bureaucrats typically have a strong bargaining position against legislators, and take advantage of the information they have regarding the implementation of public policies. According to institutional economists like North (1986) and the theory of property rights, the operation of the state enhances the security of property rights and helps promote economic development through the reduction of transaction costs.

In Greece, all these descriptions can be applied to an administration that was, in theory, established to help arbitrate differences among individuals, to implement public policies, to rectify market failures when they occur, to reduce the transaction costs of the individuals that form the society, and to enhance social coherence. However, the interests of bureaucrats are not identical to those of politicians, and bureaucrats will use their discretion to promote their own interests when feasible—that is, within the existing legal/political framework. The contradictory and vague rules in Greece, paired with unorganized and badly trained enforcers, means the bureaucracy is easily penetrated by various interest groups. Those groups can readily recruit members of the administration to their cause, because the abuse of public office is generally lucrative and goes unpunished.

This behavior is rational both for the interest groups and for the bureaucrats, and the opportunities it offers to the members of the bureaucracy who are recruited by these groups in terms of extra legal privileges, undeclared income, and other legal or illegal benefits are one of the reasons why public sector employment is so desirable in Greece.

The Failure of the Mandate Holders

The so-called agency problem is very important in the Greek political system where the interests of the mandate holders are not aligned with the interests of the voters. Mandate holders operate in an environment of weak institutions that do not foster open policy debates so that all voices can be heard. Moreover, the lack of transparency widens the gap between the interests of the (misinformed) voters and the interests of the mandate holders. In this context, politicians aim for reelection by choosing to cooperate with the interest groups—and the media they control—and by shunning reforms. The only way meaningful reform could occur would be to create strong institutions that would limit the size and scope of government.

Under a transparent rule of law and limited government, bureaucrats would have less discretion and voters would hold politicians accountable for violating the rule of law. Bringing about such a change, however, is extremely difficult. As long as reform-minded politicians face an orchestrated and powerful reaction from the media and special interest groups who benefit from the status quo, the probability of reform will be low.

It will remain unlikely that any politician will choose to take the gamble to implement reforms—even though in Greece the executive and legislature are effectively joined and it is plausible that interest groups would ultimately accept real reform if they thought everyone else would do likewise (Mitsopoulos and Pelagidis 2007a). As Mitsopoulos and Pelagidis (2009) argue, in a political system that offers no opportunities to voice disagreements or to incorporate them in the official process that shapes policies, there is little chance that politicians will promote reforms that bring about a set of rules that protect property rights, are easily adhered to, and do not encourage corruption.

The difficulty of reform is reinforced by the fact that in Greece most voters pay no income taxes. Indeed, a very small proportion of the population pays the vast majority of personal income taxes forming a much more progressive tax system than in Germany or France. Because the average Greek voter does not pay any income tax, he regards the expansion of government as a "free good." Politicians are only too happy to supply more at other people's expense. In this setting, and from a political perspective, it seems rational to promote the design of a tax structure that puts most of the burden from the income tax on a small number of high-income earners that declare their income, and then to accept widespread tax evasion, especially among middle-income earners who form a large voter pool.

This behavior of the policymakers is not driven by their political beliefs, but by rational motives and a desire for political survival in an political environment that does not reward those who serve the public interest.

Corruption and Mistrust of the Market Economy

Given that the mandate holders aim only to create rents, it is not surprising that any business initiative in Greece requires excessive time and costs, both legal and illegal, in a context of widespread corruption. Because voters tend to associate markets with corruption, they tend to mistrust the market and support politicians who favor anti-market policies (see Di Tella and McCulloch 2007). In an environment of weak governance, the public's demands for increased state intervention in the markets lead to the proliferation of exactly those causes that have lead to the high levels of corruption and the regulatory environment that favors rent seeking in the first place. Such an environment is indeed compatible with the poor performance of the institutions that should reinforce social coherence as well as with a job market that increasingly reflects a system that is not competitive enough to create a sufficient number of jobs. In such a closed system, a job becomes a scarce and coveted asset—that is, a prize that interest groups and politicians trade for. Those who are not able to participate in this rent seeking—numerous young people without any connections—face very unfavourable odds when they enter the job market.

The media and populist politicians, who have joined with interest groups, point to the high unemployment rate among young workers, and to rising inequality, as cases of market failure, not government failure. It is ironic that the failings of the Greek society and economy resulting from the extensive intervention of a captured state are blamed on the concept of free markets. Moreover, the public perception that the root of Greece's problems is too little regulation rather than too much makes it almost impossible for any politician to advocate market liberalism as opposed to market socialism.

Conclusion

In this article, we started out with a brief description of the Greek economy. We identified both the causes of the recent strong growth performance and the reasons why, despite that performance, the competitiveness of the Greek economy remains so low—namely, extensive and low quality regulation of markets, high administrative costs, a business environment that is not favorable, and weak institutions and widespread corruption.

Greece has benefited from certain reforms but is still plagued with deeply entrenched weaknesses that undermine its long-run growth potential. To achieve its potential, Greece needs to engage in wide-ranging changes that will establish competitive markets, reduce the proliferation of administrative burdens, and introduce accountability and transparency in the public administration and the government. Only in this way will the rents accrued from state intervention and high administrative costs be replaced by profits earned from competitive markets. In such a system, rewards would no longer be distributed on the basis of one's ability to secure favors from the executive and legislature but, rather, from innovation-driven entrepreneurship in free markets.

Establishing a "constitution of liberty" (Hayek 1960) will not be easy. The Greek people will have to change their way of thinking about the market system and recognize that neither the market nor the government is perfect—but that without a more open economy both personal and economic freedom will suffer.

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