Greece as a Precautionary Tale of the Welfare State

By Aristides Hatzis

Few contemporary democracies offer tales of institutional failure as startling as that of Greece. Despite a turbulent political history in the twentieth century, the Greek economy gained ground during decades of actual wealth creation, until the country's main parties started to compete on the basis of welfare statism, based on populism and patronage. Law and economics scholar Aristides Hatzis shows how short-term pursuit of political advantage through statist policies generated corruption, indebtedness, and political collapse. Hatzis is professor of the philosophy of law and theory of institutions at the University of Athens and writes about the Greek crisis at GreekCrisis.net.

Modern Greece has become a symbol of economic and political bankruptcy, a natural experiment in institutional failure. It's not easy for a single country to serve as a textbook example of so many institutional deficiencies, rigidities, and distortions, yet the Greek government has managed it. The case of Greece is a precautionary tale for all others.

Greece used to be considered something of a success story. One could even argue that Greece was a major success story for several decades. Greece's average rate of growth for half a century (1929–1980) was 5.2 percent; during the same period Japan grew at only 4.9 percent.

These numbers are more impressive if you take into consideration that the political situation in Greece during these years was anything but normal. From 1929 to 1936 the political situation was anomalous with coups, heated political strife, short-lived dictatorships, and a struggle to assimilate more than 1.5 million refugees from Asia Minor (about one-third of Greece's population at the time). From 1936 to 1940 Greece had a rightist dictatorship with many similarities to the other European dictatorships of the time and during World War II (1940–1944) Greece was among the most devastated nations in terms of percentage of human casualties. Right after the end of the war a ferocious and devastating Civil War took place (in two stages: 1944 and 1946–1949) after an insurgency organized by the Communist Party. From 1949 to 1967 Greece offered a typical example of a paternalistic illiberal democracy, deficient in rule of law, and on April 21, 1967, a military junta took power and ruled Greece until July 1974, when Greece became a constitutional liberal democracy. The economy of Greece managed to grow despite wars, insurgencies, dictatorships, and a turbulent political life.

Seven years after embracing constitutional democracy the nine (then) members of the European Community (EC) accepted Greece as its tenth member (even before Spain and Portugal). Why? It was mostly a political decision but it was also based on decades of economic growth, despite all the setbacks and obstacles. When Greece entered the EC, the country's public debt stood at 28 percent of GDP; the budget deficit was less than 3 percent of GDP; and the unemployment rate was 2–3 percent.

But that was not the end of the story.

Greece became a member of the European Community on January 1, 1981. Ten months later (October 18, 1981) the socialist party of Andreas Papandreou (PASOK) came to power with a radical statist and populist agenda, which included exiting the European Community. Of course nobody was so stupid as to fulfill such a promise. Greece, with PASOK in power, stayed in the EC but managed to change Greece's political and economic climate in only a few years.

Today's crisis in Greece is mainly the result of PASOK's shortsighted policies, in two important respects:

(a) PASOK's economic policies were catastrophic; they created a deadly mix of a bloated and inefficient welfare state with stifling intervention and overregulation of the private sector.

(b) The political legacy of PASOK was even more devastating in the long-term, since its political success transformed Greece's conservative party ("New Democracy") into a poor photocopy of PASOK. From 1981 to 2009 both parties mainly offered welfare populism, cronyism, statism, nepotism, protectionism, and paternalism. And so they remain.

Today's result is the outcome of a disastrous competition between the parties to offer patronage, welfare populism, and predatory statism to their constituencies.

What Is the Engine of Growth?

Wealth is created through voluntary cooperation and exchange. A voluntary exchange is not a zero-sum game in which gains are balanced by losses. It's a positive sum game which leads to the creation of additional value that is shared by the participants. (Involuntary transactions are often negative sum games, for in such cases the losses to losers are far greater than the gains to winners; a mugger may stab you in an alley and get 40 Euros from your wallet, but your medical bills and suffering will surely be far greater than 40 Euros, just as political struggles to redistribute wealth always involve expenditures of scarce resources on both sides—to despoil or to avoid being despoiled, and the total of those expenditures may well be far greater than the value of the wealth redistributed.)

Prosperity, whether called wealth, economic development, or growth, is positively related to the number of voluntary transactions that take place. The role of the government in this mechanism is to protect rights, on which voluntary exchanges are based, and to allow people to create wealth. The government can help this mechanism by securing property rights and enforcing contracts (thus making markets "regular," which is the original meaning of "regulation") and perhaps also by intervening carefully when there is a market failure, but without distorting the market and causing yet greater and more disastrous government failure.

Most contemporary governments have assumed another, more ambitious and dangerous, role. Not to "regulate" by establishing clear rules that make the market process "regular," but to intervene arbitrarily; not to help market transactions but to hinder them; not to protect positive-sum transactions that create wealth but to replace them with negative-sum transactions through subsidies and government spending. Most politicians today believe that if you just spend enough you will generate growth, and if there's no growth that means that they didn't spend as much as they should have. That road of accelerating government spending led to Greece's crisis, but it is not unique to Greece, for the same dynamic has led to the first credit downgrade in US history, and to today's European sovereign debt crisis.

Spending is popular for politicians because it buys votes in the short-term; after all, in the long-term we will all be dead, or at least not in power. It's popular with the voters because they tend to see government benefits as a windfall. They don't see the money as coming from their own pockets, but from "the government," or at least from someone else's pockets.

All the way back in 1974, Greek politicians forgot about economic realities. After the fall of the military dictatorship even the conservative government nationalized banks and corporations, subsidized firms, and increased the powers of the welfare state. Nonetheless, its policies were still limited in comparison with what the first socialist PASOK government did during the 1980s. After 1981, state intervention increased, and regulation and cronyism became the rule. That was also the policy of the governments up to 2009, with two minor exceptions: one of them was a short period in the early 1990s under reformist conservatives, during which almost all attempts at reform failed miserably, and the other, more successful, period was right before the entrance to the Eurozone in 2002 under reformist Socialists. But even then the numbers were fudged and the structural reforms were minimal.

How was so much spending possible, considering that Athens may well be the tax-evasion capital of the world? Since government revenue was limited due to colossal tax evasion and a perennially inefficient tax system, the rest of the money came from transfers from the European Union and, of course, from borrowing. As *New York Times* columnist Thomas Friedman aptly put it, "Greece, alas, after it joined the European Union in 1981, actually became just another Middle East petro-state—only instead of an oil well, it had Brussels, which steadily pumped out subsidies, aid, and Euros with low interest rates to Athens."

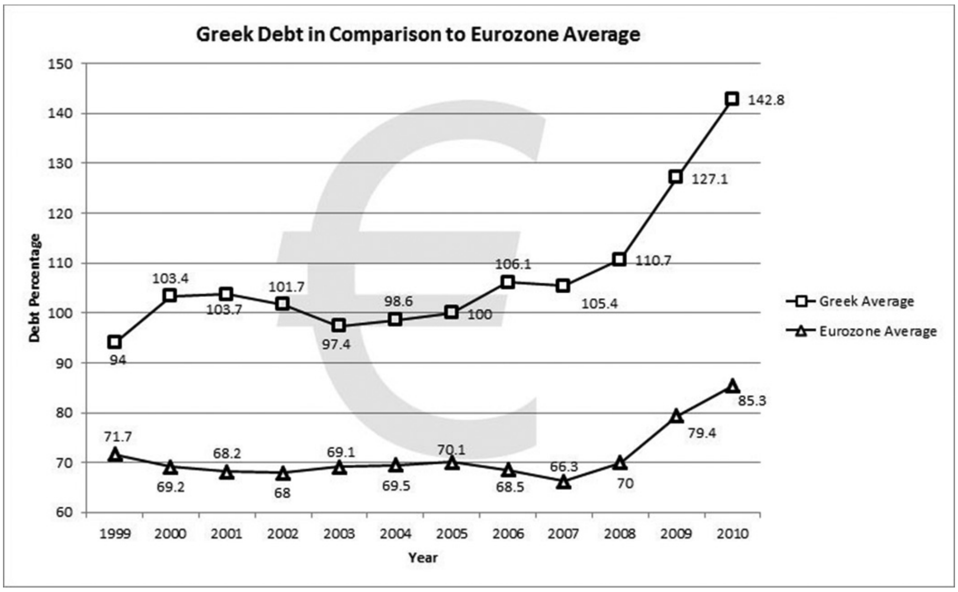
The borrowing became much easier and cheaper after Greece adopted the Euro in 2002. After 2002, Greece enjoyed a long boom based on cheap and plentiful credit, because the bond markets no longer worried about high inflation or a devalued currency, which allowed it to finance large current-account deficits. That led to a crippling €350 billion public debt (half of it to foreign banks) but, more importantly, also to a negative effect that is rarely discussed:

> The transfers from the EU and the borrowed money went directly to finance consumption, not to saving, investment, infrastructure, modernization, or institutional development.

The Greek "party time" with the money of others lasted 30 years and—I must admit it—we really enjoyed it! Average per capita income reached $31,700 in 2008, the twenty-fifth highest in the world, higher than Italy and Spain, and 95 percent of the EU average. Private spending was 12 percent more than the European average, giving Greece the twenty-second highest human development and quality of life indices in the world. If you are impressed, remember that even those figures grossly underrepresented reality, because Greece's underground economy may amount to 25–30 percent of GDP!

The unreported income is mostly related to tax evasion. Even in 2010, some 40 percent of Greeks did not pay any tax and about 95 percent of tax returns were for less than €30,000 a year. Such widespread tax evasion cost the state budget an estimated €20–30 billion per year, i.e., at least two-thirds of the deficit for 2009.

Greece was morally and economically mired in corruption. Consider the tragicomic and infamous swimming pools of Athens. A swimming pool is an indication of wealth in Greece, so the Greek revenue service uses them to detect tax evasion. In 2009, only 364 persons declared that they had pools at home. Satellite photos revealed that there were, in fact, 16,974 private house pools in Athens. That means that only 2.1 percent of the people owning pools submitted truthful tax forms. The interesting question is not why the 97.9 percent lied, but why the 2.1 percent did *not* lie, since tax evasion in Greece is so widespread.



Source: Eurostat. See also: http://www.rooseveltmcf.com/files/documents/ BULLX-Greece-Aug-2011.pdf

Lying became a way of life in Greece. Still, one might argue that lying to protect what one has created is justified. But in Greece that wealth was not created, but simply borrowed. In 1980 public debt was 28 percent of GDP, but by 1990 it had reached 89 percent and in early 2010 it was more than 140 percent. The budget deficit went from less than 3 percent in 1980 to 15 percent in 2010. Government spending in 1980 was only 29 percent of GDP; thirty years later (2009) it had reached 53.1 percent. Those figures were hidden by the Greek government as late as 2010 when it admitted that it had not actually met the qualifying standard to join the Eurozone at all. The Greek government had even hired Wall Street firms, most notably Goldman Sachs, to help them fudge the numbers and deceive lenders.

That sorry state of the Greek economy was the result of two factors:

- the gross inefficiency and corruption of the Greek welfare state; and
- the thicket of impediments to voluntary economic transactions, created by welfarist interventions.

According to the annual *Doing Business* survey of the World Bank for 2012, Greece was one hundredth out of 183 countries around the world in terms of the overall ease of doing business. It was, of course, the worst place in both the European Union and the OECD (Organisation for Economic Co-operation and Development). Greece, a European Union member for the past thirty years, a member of the Eurozone for the past ten years, the twenty-fifth richest place on the planet, ranked below Columbia, Rwanda, Vietnam, Zambia, and Kazakhstan. As the *Wall Street Journal* put it: "a country has to work hard to do this poorly." Greek government policy was hostile to free enterprise and private property and severely obstructed labor and capital mobility, generally in the name of "social solidarity" and "fairness."

Greece Hates Business

Where Greece ranks, among 183 countries, on measures of doing business

Field	Ranking
*Ease of Doing Business	109
Starting a Business	140
Dealing with Construction Permits	50
Employing Workers	147
Registering Property	107
Getting Credit	87
Protecting Investors	154
Paying Taxes	76
Trading Across Borders	80
Enforcing Contracts	89
Closing a Business	43

*Overall ranking based on the 10 categories below

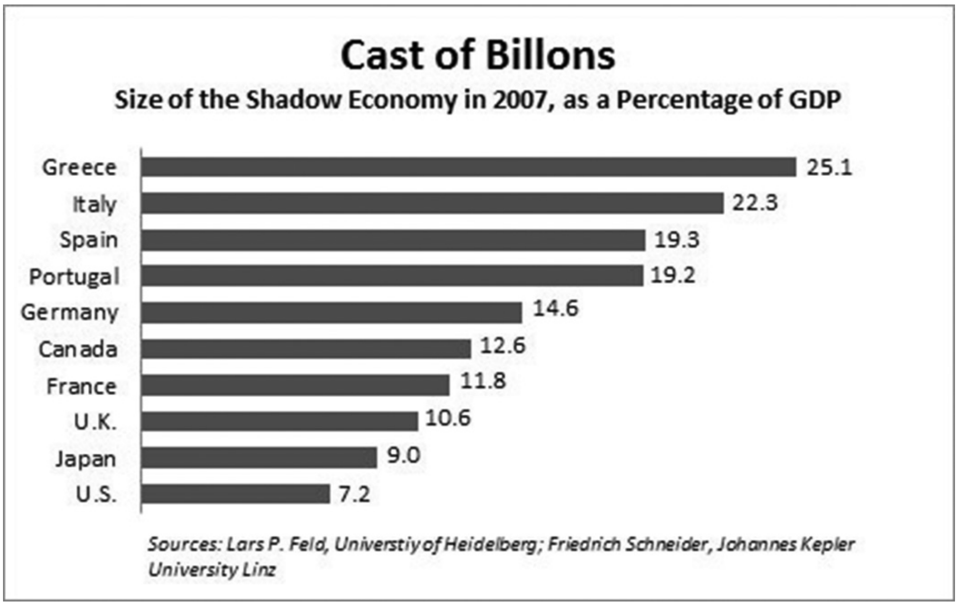
Source: World Bank, Doing Business 2010

Source: http://online.wsj.com/article/SB10001424052748703961104575226651125226596.html

To start a new business in Greece in 2010 you needed an average of fifteen days and €1,101 when the average for the rest of the EU was eight days and only €417. Filing taxes took 224 hours a year in Greece; in the richest European Union state, Luxembourg, it took only fifty-nine. The ranking for the protection of investors was deplorable: 154th out of 183. Greece's best ranking was for the ease of closing a business; Greece ranked forty-third.

Almost all the professions in Greece are in some degree highly regulated and cartelized, which imposes costs on consumers and obstructs wealth creation. Add to that a hideously inefficient bureaucracy that costs Greece 7 percent of GDP, double the European average.

Interventionist bureaucracies tend to breed corruption. According to a Transparency International report, the cost of petty corruption was about €800 million ($1.08 billion) in 2009, an increase of €39 million over 2008.

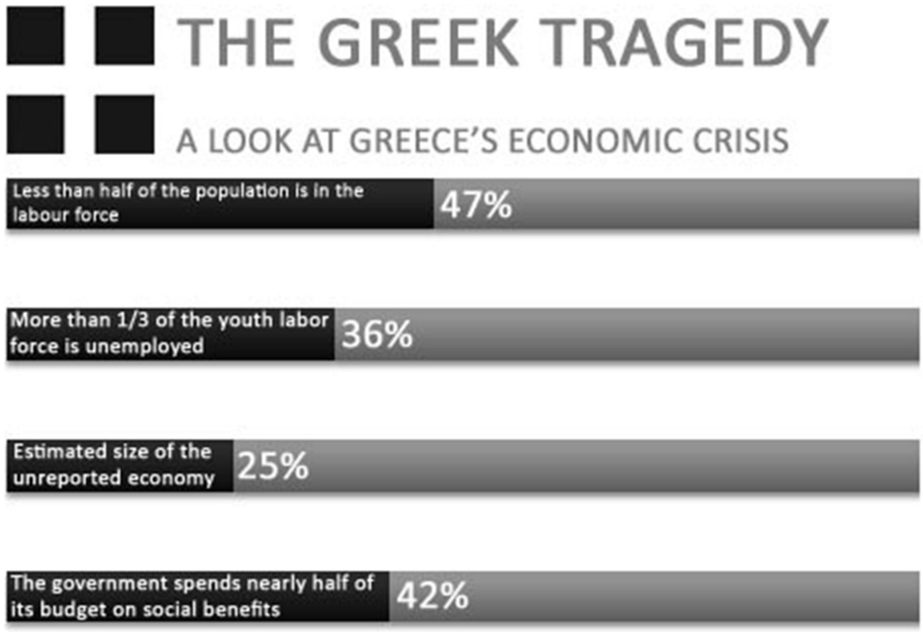


Source: http://online.wsj.com/article/SB10001424052748704182004575055473233674214.html

Unsurprisingly, Greece has the least competitive economy among the 27 EU members. According to the Global Competitive Index of the World Economic Forum for 2010–11, Greece ranked eighty-third, below countries such as Vietnam, Jordan, Iran, Kazakhstan, Namibia, Botswana and Rwanda. According to the 2011 World Investment Report by the United Nations Conference on Trade and Development, Greece is ranked 119th out of 141 countries in foreign direct investments. No wonder that over 50 percent of young Greeks are unemployed. That is the result of a business environment that discourages entrepreneurship, where bureaucratic costs are so high and there is so much corruption.

Greece's bloated welfare state has convinced many that their benefits have the status of "social rights." It would be political suicide for a politician or a political party to make significant cuts when the population has been accustomed to so many state-granted "rights" and an aging population has been promised huge health and retirement benefits.

Greece is the textbook example of the generation of unsustainable "rights." The government spends €10,600 per person on social benefits but brings in only €8,300 per person in revenues. This leaves a €2,300 deficit per person!



Source: http://fxtrade.oanda.com/analysis/infographics/greece-economic-crisis

At the same time, wages in the public sector have risen in real terms (from 1996 to 2009) by 44 percent. (In some sectors they rose by up to 86 percent.) Employees received the equivalent of 14 salary payments a year, including two additional payments as bonuses (one for Christmas, half during the Easter vacation, and half before the summer vacations). Pensions also rose substantially.

A Greek man who had worked for 35 years in the public sector had the right to retire on a generous pension at the age of 58. Women could retire even earlier; if a woman had an underage child she could retire at 50. The average retirement age in Greece was 61; in Germany it was 67. Greece's over-65 population is projected to grow from 18 percent of the total population in 2005 to 25 percent in 2030.

One might argue that as expensive as the welfare state may be (it cost 19 percent of GDP in 1996, but 29 percent in 2009), at least it provides some sense of security and limits inequality. Not in Greece! Even though health and education are provided "free" by the state, the Greek family pays 45 percent of the total medical expenditure (mostly in bribing doctors, nurses, and public servants to do their jobs). Many (2.5 percent) Greek households go bankrupt every year because of high medical expenses. The same goes with education. Even though it's "free" at all levels, Greek households spend more for the education of their children (for private tutoring) than any other in the EU.

The long party financed by borrowing is winding down. The hangover is setting in. Now is the time to sober up, rather than reach again for the bottle of public debt. Cronyism and corruption should be tackled and markets should be freed. People should have the freedom to create wealth through voluntary exchange. The Greek kleptocracy should be replaced by the rule of law. A safety net for the misfortunate poor should no longer be the excuse for lavish benefits for the powerful and the wealthy that have left the poor and the powerless worse off than otherwise.

The lesson is that economic development and prosperity do not come from government borrowing and spending. Prosperity comes from the market, from voluntary transactions, from saving, investing, working, producing, creating, and trading. Government has an important job to do in creating the rule of law, the security, and the legal institutions that make those voluntary transactions possible; it neglects those important responsibilities when it creates instead giant bureaucracies, unsustainable entitlements, and a system of theft, corruption, privilege, and dishonesty.

Greece's predicament is severe. It will not be solved overnight. But it can be solved, with the right remedy.