In: Greece: Economics, Political and Social Issues
Editor: Panagiotis Liargovas
ISBN 978-1-62100-944-3

Chapter 2

STABILIZATION AND REFORM IN A STATIST REGIME, 1974-2011

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Abstract

This chapter deals with the politics of economic stabilization and reform in Greece and addresses questions already raised in the literature. The focus is specifically on the changes in economic and social policies characterized by a transition from statist designs to ambivalent liberal reforms. Thereby, we do not address one policy field alone but look at a number of core issues or policies that include fiscal discipline, product and labor market reforms, privatization, pensions and environment. The analysis, covering the entire time span from 1974 on to the present, is a tale of an ultimately failed liberal adjustment. To explain it we apply mainly soft public choice approaches about interest-based behavior; (institutionalist) references to path–dependent political norms and practices and formal rules of the game; and, inevitably, ideas, while allowing for the impact of multilateral arrangements and crisis as external inducements to reform. The course of things and the exemplifications we provide invite to a reexamination of the ultimate balance between institutionalized coordination mechanisms of the EU and domestic forces.

Introduction

Greece is assessed as a case of unstable stabilization and unfinished reform[1], leaving the country without defenses against the 2008-2009 financial crisis and recession. This is even more important, considering that Greece joined the euro zone in 2001.

Greece experienced significant political and economic changes since 1974. To understand what happened since 1974 we divide the whole era in two periods: the first one ended in 1989-90; the second covers the rest of the time to the present crisis (2010-2011). We begin with explaining the initial situation in the late 70's and early 80's. The following section outlines the mounting difficulties of the populist management of the economy during

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the 80's. Populism has been associated with a strong expansion of state interventionism by the socialist movement (PASOK). The third section gives a short account of the admittedly hesitant, politically difficult and ultimately unsuccessful attempts to stabilize the economy and reform policies since the beginning of the 90's up until 2008-10 and explains how they interacted with European integration. A section then focuses on the current fiscal and economic crisis 2009-11. The final section raises some more fundamental questions about the tensions between international economic environment and domestic factors. Understanding what went wrong is potentially of some academic and political importance.

Transition to Democracy and expansion of state interventionism in the late '70s.

After the collapse of the dictatorship (1974), democratic governments had to cope with a set of difficult problems- the military defeat on Cyprus, the first oil crisis and the multiplications of expectations for better economic conditions. So far as the economy was concerned, the then governing party of new Democracy, a coalition of centre-right forces, extended state interventionism through harsh nationalizations and rapidly increasing public expenditure. The size of the state grew from roughly 33% (1973) to almost 40% of the GDP (1981). The course was expected to consolidate democracy against rising anti-capitalist sentiment reflected in the rise of the Panhellenic Socialist Movement (Pasok) under A. Papandreou[2].

After the breakdown of the authoritarian regime 1967-1974 Greece experienced an astonishing renewal of its post-war statist economic policy paradigm. The process was paradoxically led by the New Democracy party (ND) that declared itself as radical liberal[3][4]. The government of K. Karamanlis drew from some past successes: The post-war statism was initially associated with high growth and remarkably low inflation rates. Later on however, roughly since the end-70's it proved unable to generate growth. After the second energy crisis in 1979 and during the 80's the Greek economy slipped in a prolonged stagnation period, characterized by increasing unemployment, budget deficits, debts and inflation rates as well as worsening productive structures ("de-industrialization").

While reviving post-war statism, the Greek government accelerated integration in the EU and applied in 1975 for full membership without waiting for the full implementation of the Association Agreement of 1962 that entailed transitional provisions extending until 1984. Overlooking some economic and social realities, Prime Minister Konstantinos Karamanlis considered membership as an additional instrument to consolidate the 1974 restored Democracy and as best serving the long-term security interests of Greece. He also linked membership to the survival of the economic model of market economy in the country.

The Commission, however, was rightly concerned over Greece's ability to adapt. According to its opinion presented to the Council in January 1976:

> *"The Greek economy at its present stage of development contains a number of structural features which limits its ability to combine homogeneously with the economies of the present member states."[5]*

To implement the necessary institutional and structural changes, even with the Community's support, would be a very complex and demanding task. Therefore, the

Commission recommended a transitional period of some years "before the obligations of membership, even subject to transitional arrangements, are undertaken" (Ibid: 10).

Greece did not accept the opinion of the Commission and pressed ahead for a quick decision on full membership. The Accession Treaty was signed in May 1979 and entered into force on 1 January 1981.

The situation in the '80s: Stagflation.

In October 1981, shortly after accession, the socialists (PASOK) achieved a sweeping electoral victory. Whilst in opposition the party rejected membership, seeing it as a major obstacle to socialist aspirations As it had declared before assuming governmental responsibilities, EU accession "will consolidate the peripheral role of the country as a satellite in the capitalist system; will render national planning impossible; will seriously threaten Greek industry; and will lead to the extinction of Greek farmers." [6][7]

In government, however, the socialists recognized to a certain degree international political and economic realities but they implemented contradictory policies: They decided not to leave Union in which competition was the norm and at the same time applied extensively traditional socialist instruments.

The socialist governments that dominated the scene until 1989, implemented on the whole, but with a short-lived stabilization effort in 1985-6, economic policies with strong populist characteristics: They increased social expenditure particularly for pensions, nationalized further parts of the Greek industry and banking sector, extended government "guidance" in key sectors, experimented heavily with central planning methods, expanded worker's participation in state owned enterprises and public employment[8]. In 1983 the government established the so called Industrial Restructuring Organization (IRO)– a public holding group for ailing enterprises- and brought under IRO control a big number of private firms for restructuring purposes partially with illegal methods. For many years the IRO managed the firms poorly, absorbed a lot of money and simply subsidized heavily otherwise not viable firms, which were kept in a quasi-public status and exhibited deteriorating performance.

Statism took new forms and penetrated worryingly both the economy and the society. In institutional terms and policy orientation, Greece diverted from its partners in the EU.

Associated with expanding statism was an excessively expansionary macroeconomic policy throughout the '80s. As the OECD commented "the most spectacular and probably the most damaging feature" of the macroeconomic management during the last decade was the steep increase in the public sector deficit[9]. But, supply stagnated. Prominent among the factors responsible for the weak responses to growing demand for goods and services fuelled by fiscal deficits and the influx of EU resources, were initial wage increases and a political climate unfavorable for private initiatives. In the late '80s and early '90s Greece was caught in a stagflationist trap.

In the late '80s budget deficits and public debt expanded worryingly, based on the mistaken crude keynesian assumption, that they would lead to growth recovery. The budget deficit increased from 2.6% GDP (1980) to 16.1% (1990). At the same time inflation jumped again up to 20.4 percent (1990) after a short-lived stabilization period. Total public debt rose from 28.6% GDP in 1980 to 80.7% GDP in 1990[10].

Professor S. Spraos, a leading economist of the Greek Diaspora saw Greece suffering under the so-called "Dutch disease" experienced by the Netherlands during the natural-gas boom there in the '70s. In Greece easy money came not from natural resources but from the EU, whose resources kept the exchange rate high and inflation up, thus putting the rest of the economy under additional pressure. De-industrialization was the result[1].

Joining the Union on the road to EMU: Stabilization without reform.

In the meantime the ambitious EU-program to create an internal market by abolishing a whole range of protectionist controls and other practices with similar effects was progressing and rapidly creating a new economic environment. Moreover, in 1991 the Treaties were reformed to establish an economic and monetary union (EMU). Both, internal market and EMU reflected a new, essentially liberal (or monetarist) consensus among European governments. Greece had formally subscribed to it. "Nominal convergence", by which was meant the fulfillment of the so-called "Maastricht criteria" of low inflation, deficit reduction etc as a precondition for participating in the monetary core, became an immediate target in the EU.

In Greece a broad consensus between the major political forces in Greece has been established in the 1990s, that Greece should join EMU (Euro-land) at the earliest possible date. Political reasons seem to have played a crucial role in forming this consensus. The political leadership was (and remains) convinced that only through the EMU participation can the country have a say in important community policy sectors "on an equal footing" with the other member states as Prime Minister K. Simitis repeatedly argued. Participation would also send a clear signal to third countries that Greece is indeed a part of the European gravity centre. Prestige and national identity considerations may also have played a role[11][12]. Since World War II Greece has always seen itself as integral part of the European project and this would be endangered if the country could not join the new ambitious step in the history of integration. But, certainly, economic considerations, for example, to halt the cost of borrowing, cannot be overlooked[13].

Together with the disappointing experience of the '80s, the developing legal and institutional framework of the EU exercised strong pressures to remold economic and social policies and limit the scope for old tailored state interventionism. In the new European (and indeed international) environment the tendency has been for regulation in privatized sectors to replace state administration and public ownership, and for competition to replace multiple forms of protection and monopoly building [14][15].

There has been however an apparent tension between political consensus for the EMU on the one side, and every day politics, on the other. The politics of adjusting to the EMU environment were characterized by inconsistencies and delays. Many forces worked to preserve the status quo.

Early de-etatization plans.

[1] See reference in Panos Kazakos (2001), p. 402.

The first stabilization attempt (1991-1993) failed despite the generous support of the EU in the framework of an agreed stabilization program. The program aimed at both, restoring macroeconomic balance and initiating deep structural adjustments. The centre-right government under Prime Minister K. Mitsotakis (1990-1993) and its economic policy core envisaged, as they put it, an ambitious “de-etatization of the economy”. They encountered however broad and strong opposition from organized interests in and around the giant state apparatus and from a public opinion still impressed by the populist promises of the ‘80s. However the government had succeeded in halting the slippery road to bankrupsy, in accomplishing limited privatization and in stemming the rapidly deteriorating financial position of the pension system.

By that time, the pension system deficiencies had already become apparent and, indeed, threatening. The pension system was extremely complex, fragmented and financially unsafe. The contribution of revenues from employers and employees were (and, despite changes, still are) insufficient to pay for the current (and expected) level of pensions with the resulting deficits financed by the budget. The system distributed state subsidies inequitably, as an official memorandum later pointed out, and gave rise to disincentives for labour mobility, savings, normal retirement and compliance with the contribution rules. Its bureaucracy “often leads to services deficient in quality” and high costs[16]. The variable geometry of the pension system had of course its origins in the particular circumstances of the ‘50s and ‘60s as well as in the clientelistic practices of the country.

The 1991 pension reform included sharp increases in contributions rates which placed Greece among the countries with the highest non wage labour cost, eliminated the link of pensions to wages and tightened invalidity eligibility. Through these measures the pension system gained a temporary breath.

Further, public enterprises posed particular problems to the economy. According to an estimation of the Ministry of National Economy it comprised in 1997 nearly 50 enterprises and employed about 130.000 individuals, equivalent to 6 per cent of wage earners. Most of them operated often inefficiently and offered unsatisfactory services or products in terms of cost and quality. They became a burden not only for the state budget, but also for the rest of the economy. In a special feature included in the 1998 country report the OECD located the sources of the poor performance in the pricing policy of the enterprises, in the inflexible labour arrangements and high labour costs, in the extraction of monopoly-power rents by the unions operating in the public sector and in critical investment lags[17].

The poor financial performance of public enterprises required financial assistance from the central government, equivalent to nearly half of Greece’s large debt burden (with the latter amounting to nearly 110 per cent of GDP at end-1997). Behind these pathology worked strong clientelistic links between party functionairs, party controlled unions, interested private suppliers with political connections and the government[18].

The liberal-conservative government (1990-1993) initiated a first round of measures to slim down the public enterprises sector. Some initiatives were brought to a positive end (for example the big cement producer AGET has been successfully transferred to private hands) but the whole program of “de-etatization” came to a halt as early as 1993. Several factors were responsible for this early failure, among them the instability of a government which could only count on a marginal majority, a still unfavorable public opinion, internal tensions in the governing party between liberals and conservatives, serious policy design mistakes as a result of lacking experience and an aggressive opposition, dominating the unions of the public sector and still promising to renew the populist politics of the '80s. The etatist tradition in all its versions had deep roots and was sustained by multiple institutional arrangements and informal practices.

Stabilization with limited reform and euro zone entry: 1994-2000.

A new attempt primarily aiming to stabilize the economy, was vigorously pursued after 1996 by the new prime minister K. Simitis and brought a small but temporary miracle at the stabilization front[19].

On the way to the single currency zone the Central Bank legislation and statute was amended to comply with the Treaty requirements. The prime objective of the Bank of Greece became to ensure price stability as member of the ESCB. The Bank obtained for the first time in the post-war area an independent status.

By the end of 1999 Greece appeared to have re-established macroeconomic balance and fulfilled the Maastricht-criteria as laid down in the Treaty of the EU[2]. Fiscal discipline had been attained although it remained fragile and inflation had been brought in 1999 to the lowest point of 2% (CPI) in almost 30 years to go up again afterwards. Also, growth outstripped the euro area average since 1996 thus achieving real convergence measured in terms of per capita GDP[20]. Growth benefited from the large resource transfers from the EU through the Community Support Framework 1994-1999, lower interest rates and the influx of immigrants that lowered labor costs. Additionally, Greece seemed to improve its overall competitiveness as measured in the World Competitiveness Yearbook. The country ranked 30th (2001) against 36th in 1997 and was now in a comparatively better position than Portugal and Italy[21].

Additionally, some necessary reforms have been implemented on the way to the introduction of euro despite widespread resistance. Liberalization mainly in the telecommunication and banking sector has progressed well. In the telecommunications sector, the privatization limit for the public operators has been lifted and the whole sector is open to competition since early 2001. The banking sector was also liberalized during the '90s in compliance with EU regulation associated with the internal market. The result has been an accelerated restructuring and concentration of private banks and the privatization of some public or state controlled banks.

On 9 March 2000 the Greek government felt in a position to request a re-examination of its convergence situation and, thus, opened the procedure by which the Council could decide on the admission to the single currency of a member state with derogation. After positive assessments by the Commission and the ECB[22], Greece became in June 2000 a full member of the monetary core of the Union dominated by a European Central Bank and promoting the issue of a single currency.

[2] See Article 121(1) of the *EU-treaty* (Maastrict) as well as *protocol* No 21 on the convergence criteria referred to in Article 121.

Greece's achievements on the road to the Euro-zone are all the more remarkable as both its budget deficit and inflation rate were at the start (1994/5) four times higher than in the euro-zone member states just a few years earlier and were coupled with stagnation. However, uncertainties overshadowed the convergence project. After Euro-zone accession, Greek fiscal policy seemed to loosen again. A first EU audit in 2002 resulted in a limited upward "correction" of official data about deficits and debts but a second one in 2004/5 revealed more serious problems with official data and extensive "creative accounting" by the government[23]. Moreover, Greek fiscal position was considered to be unsustainable on the long run[24]. The country's Achilles heel were the underlying structural and institutional problems.

The euro-zone accession was the culmination of ten years of effort to keep pace with the most ambitious integration project of the EU. From a political point of view the success should have meant that the political system of Greece would henceforth need to work inside a more narrowly defined action field, defined by the Growth and Stability Pact and competition in the internal market.

Amidst broad euphoria[25] the government recognized that[3]

> *"the success of macroeconomic policies depends on, inter alia, the smooth functioning of individual markets: the goods, services, capital and labour markets […] To ensure that the Greek economy remains dynamic and competitive in the new economic environment, we will pursue a prudent fiscal policy, and undertake all the necessary structural reforms to improve the functioning of markets and increase the potential output of the economy so as to ensure high rates of growth with low inflation*[26]*"*

However, many of the reform measures adopted in the last half of the 90's were the result of compromising with the strong unions of the public sector, which in turn make possible to achieve declared goals. For example, the so-called partial privatization (sell of minority shares) did not lessen the control of the union-party-ministerial bureaucracy upon the enterprises nor diminished the influence (through party links) of privileged suppliers. Two attempts to restructure Olympic Airawys failed[27]. The labour market law adopted in December 2000 increased bureaucracy, not flexibility in the labour markets. And the planed fusion of the pension funds of the bank sector would in fact weaken the general Social Insurance Foundation (IKA) by taking out of it the pension funds of private banks and consolidating already existing pension privileges of the state bank employees.

Similar observations can be made with regard of the government-party-business relationships. The new European environment has indeed generated more intense competition in many sectors, but in crucial sectors individual firms or groups gained privileged access to public construction and procurement through a combination of clever political connections, electoral grants, control of mass media and ownership of popular sport clubs, thus. Reforms, such as partial privatizations have not changed much in the way the system works.

[3] In an optimistic mood, the first Stabilization and Growth Program reiterated that *"the entrance of Greece in the euro zone from January 2001 marks the start of a new era for Greece by creating the right conditions for sustainable growth."* Hellenic Republic- Ministry of National Economy and Finance *The 2000 Stability and Growth Program*, Athens, December 2000*Ibid,* p. 19.

The day after. Greece in the Euro-zone: 2001-2009.

It is broadly accepted that EMU has wide implications even in policy areas that remain in the responsibility of national governments and have not been directly addressed by the Maastricht Treaty such as labour markets policy, state productive activities and social policy. EMU and the EU as a whole have acted as a powerful catalyst for domestic reform in all member countries. The debate at EU level ran under the heading "conditions for the success of EMU".

Modernization abandoned: 2001-2004

Greek officials have recognised, in philosophical as well as practical terms that Greece, stabilisation apart, was after Euro-zone entry faced with the additional challenges of stepping-up the structural reforms required to prepare the economy for the demanding competitive environment of monetary union. [4]

The Bank of Greece resumed regularly the debate on structural adjustment *inter alia* on the occasion of its Annual Report[28] [5]. In the Bank of Greece reports, successive governors (N. Garganas, Lucas Papademos, G. Provopoulos) called for accelerated structural reforms in order to cope with the challenges generated by the EMU membership. Structural changes, they reiterated again and again, were necessary if the country wanted to cope with the challenges of stable money (the Euro) and to maintain a high growth rate and create more jobs. They particularly stressed, that the government needed to open up key markets, implement consistently privatizations, upgrade the education system and create a favourable environment for business. N. Garganas, the deputy-governor of the Bank of Greece, sees structural adjustment as closely interrelated with the need of coping with eventual shocks.[6].

But, after the introduction of Euro discipline weakened. In many ways the discipline effect of the euro system proved to be greater when applying for membership in the Euro-zone than afterwards. Greece continued to experience over-indebtedness despite EMU commitments and despite agreement among experts that mounting public debt imposes large costs on present (through interest rates) and future generations. Deficit reduction on a sustainable base was repeatedly postponed and the state of public finances regularly obscured through creative accounting. The lowest deficit was -3,2% in 1999!

Reforms were watered down or abandoned. The pension system is a good example to illustrate reform delay. According to the OECD, the Greek system was in a far more shaky position than in higher income countries as illustrated in the present value of *net* (uncovered by contributions) future pension liabilities of the order of 200% of GDP[29]. The socialist government recognized that changes could not be postponed for long. The Government reassured in the its "Stability and Growth Program 2000-2004 that the reform of the social security system, "in light of the adverse demographics forecast for the medium-term", was on

[4] Speech of the minister Yiannos Papantoniou in a conference organized by the Bank of Greece, on 16 June, 2001 in honour of the accession to the euro zone, *Athens News*, 17 June 2000.

[5] Bank of Greece *Annual Report of the Governor 2000*, 2005, 2007, 2008, 2009, Athens, and earlier issues.

[6] See his address on *" Integrating Greece into the Euro Area: The challenges ahead"* at the "Athens Summit 1999", 18 September 1999, mimo.

the agenda for immediate action[7]. It had twice, in 1998 and 2000, commissioned studies to prepare the ground for a deep reform. The first study, conducted under the lead of Prof. Spraos has been quickly withdrawn after sharp reactions of the unions and party segments, arguing that the study reflected a "neo-liberal" spirit already tested in General Pinochet's Chile! The second study, commissioned to the British Government Actuaries had not a better receive inside and outside the government camp. The study was completed in March 2001 and was followed by a formal proposal of the minister Tassos Giannitsis to the social partners.

The report of the British Government Actuary's Department concluded in a rather cautious phrasing that the Greek pension system needs from a long-term point of view more than "parametric" changes. On this basis of a report[30] the labour minister T. Yiannitsis presented proposals that left basic features at the heart of the Greek pension system untouched. He rejected diluting the public character of the system or introducing of privately-financed provisions for old age or limiting the so-called pay-as-you-go principle. Instead, the government proposed a prolongation of working life to 65 years for men and women and even for those working in hazardous professions, a lowering of the pension benefits (as percentage of the wage) and cutting the number of public pension funds, which produces red tape and covers big inequalities in the pension benefits[31].

The Labour Confederation, led by representatives of the public sector unions, rejected any negotiation on this base and met the government on the streets. After an impressive protest demonstration, the biggest for many years, and a general strike on May 17, 2001, the whole procedure was stalled[8]. Leading party and government figures denounced the proposal as "neo-liberal". The Unions presented lastingly an alternative defending essentially the status quo[32] and demanding more transfers from the budget. The project failed. The efforts to reform Greek pension system would be resumed only six years later, in 2007 [33].

Another telling example was a bill on labour market reform that the government passed in December 2000 through the parliament. The bill tackled the remaining impediments to part-time employment but it also includes mandatory premiums and detailed limits for overtime work. It also limited the discretion of the management in handling questions of over-time work. The Federation of Greek industrialists criticized that the bill increases labor cost by roughly 14% and that it was counter-productive in view of the demanding preparations of the firms for the transition to the euro currency.

Things changed after the fiscal crisis of 2010 (see below) confirming somehow that an economic crisis is likely to induce necessary reforms.

"Reinventing the state" fails: 2004-2009.

In 2004 the liberal-conservative ND came back to power promising *inter alia* to fight corruption and to "reinvent the state". On both promises the record was poor. Between 2002 and 2004 there has been evidence of widespread misreporting of deficit and debt data by the Greek authorities. Following it, the Commission demanded a revision of many data. The significant revision that followed after 2004 has been heavily contested by the socialists but

[7] *Ibid,* p. 24.
[8] See newspaper reports from 20th April 2001 onwards.

did not resulted in a significant improvement of the quality of data and the institutional framework.

Under a deficit excessive procedure it also reduced deficits approaching the limit established by the GSP. On the reform front, the government attempted to lower taxes acting in a rather liberal spirit and under the responsibility of the minister of the economy G. Alogoskoufis. But in 2007 deficits began to climb up again because public revenues and expenditure came out of control as a consequence of underlying structural deficiencies (malfunctioning tax authorities, widespread tax evasion, loose legal procedures, corruption, waste in public works and so on). Clientelism flourished.

Even before the 2009 recession, Commission projections had shown that accumulated debt and demographic developments made fiscal sustainability an acute challenge and required both bold fiscal consolidation programs and reforms of social protection. Therefore, Greece appeared to be *"a high long-term risk with regard to the long-term sustainability of public finances*"[34].

Under liberal-conservative rule Greece made some progress in privatizing state-owned enterprises. Two public enterprises producing gargantuan deficits were privatized (Olympic and Commerce Bank) even though with high costs (unreasonably high compensation for 'voluntary' redundancy, taking over existing pension rights and so on) and minority shares of the Telecommunication Company were sold.

Broader reform plans remained unfinished. The laws establishing evaluation procedures for the Universities were not implemented. A new attempt in 2007 to reform the fragmented pensions system emphasizing the merge of a great number of funds generated mainly formal rearrangements. The funds retaining their autonomy.

Then, the state of public finances worsened rapidly in 2009 as the crisis reached Greece. The ND-government deployed discretionary measures to counter recession. It implemented a combination of instruments- relaxation of tax collection, tax reductions aimed at stimulating the replacement of old cars, cash transfers to weak groups and expansion of state employment. The policy response revealed either unjustified optimism with regard to the potential of fiscal activism or confusion and electoral considerations. Thereby the Greek government followed a broader trend in Europe where Governments enacted several rounds of activist fiscal policy during the recession 2008-9, mainly expenditure increases either to save banks or to stimulate the economy. This led to a serious deterioration of fiscal deficits and rapid accumulation of debts in Europe (and elsewhere) [35]. But Greece experienced the most striking deterioration of its fiscal position due to the unfavorable initial conditions. In 2009 the deficit increased from circa 6% to 15,5% of GDP and the accumulated debt to over 126% of GDP (see table 1). The already alarming "sustainability gap" worsened. The government overlooked academic warnings about the effectiveness of fiscal activism and important suggestions for the policy design. The result was that the Council formally regretted the renewed problems in the Greek fiscal statistics in October 2010.

Table 1.
Main features of country forecast - GREECE

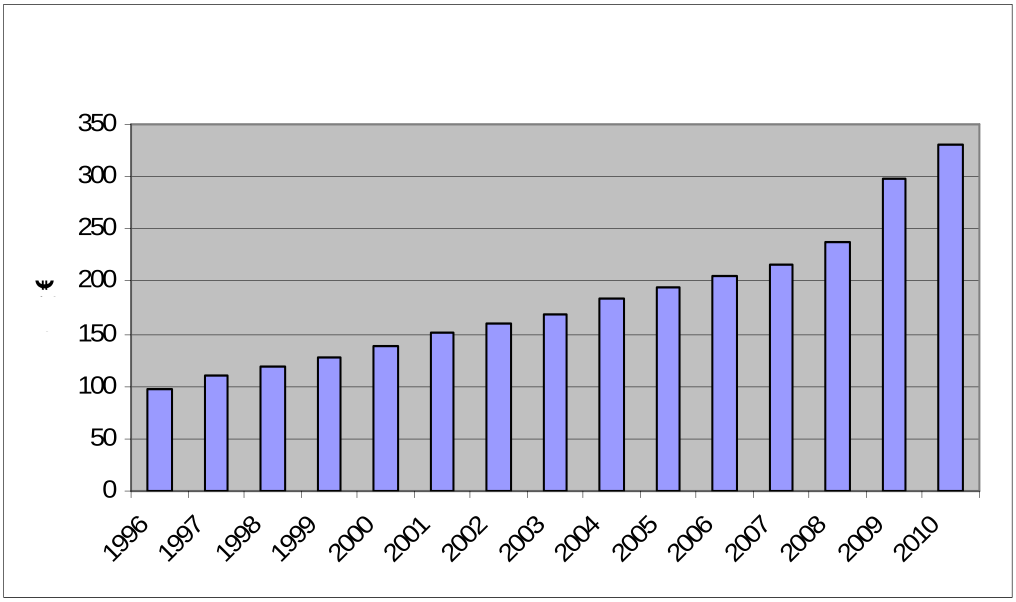
	2009			Annual percentage change					
	bn EUR Curr. prices	% GDP	92-05	2007	2008	2009	2010	2011	2012
GDP	233.1	100.0	3.0	4.3	1.3	-2.3	-4.2	-3.0	1.1
Private consumption	174.4	74.8	3.1	3.1	3.2	-1.8	-4.1	-4.3	0.5
Public consumption	45.4	19.5	2.6	9.2	1.0	7.6	-9.0	-8.5	-6.0
Gross fixed capital formation	40.1	17.2	4.3	5.3	-7.6	-11.4	-17.4	-7.5	-2.6
of which : equipment	17.9	7.7	8.6	21.9	6.2	-12.2	-13.0	-7.3	-3.1
Exports (goods and services)	44.3	19.0	6.3	5.8	4.0	-20.1	0.6	5.1	6.0
Imports (goods and services)	69.5	29.8	5.8	9.8	4.0	-18.6	-12.0	-6.4	-1.5
GNI (GDP deflator)	226.7	97.3	2.8	3.3	1.0	-1.8	-4.3	-3.1	1.0
Contribution to GDP growth : Domestic demand			3.4	4.9	0.9	-2.2	-8.0	-6.0	-1.0
Inventories			-0.1	1.3	0.8	-2.1	-0.1	0.1	0.3
Net exports			-0.4	-2.0	-0.5	2.1	3.9	2.9	1.8
Employment			1.2	1.7	0.2	-0.7	-2.8	-2.6	0.1
Unemployment rate (a)			9.9	8.3	7.7	9.5	12.5	15.0	15.2
Compensation of employees/head			7.9	6.2	6.8	2.3	-1.8	-0.2	0.1
Unit labour costs whole economy			6.0	3.7	5.7	3.9	-0.4	0.1	-0.9
Real unit labour costs			-0.2	0.6	2.4	2.7	-3.2	-1.4	-1.3
Savings rate of households (b)			-	-	-	-	-	-	-
GDP deflator			6.3	3.1	3.2	1.2	3.0	1.5	0.4
Harmonised index of consumer prices			-	3.0	4.2	1.3	4.6	2.2	0.5
Terms of trade of goods			0.0	0.8	-3.3	1.0	1.0	0.1	-0.6
Trade balance (c)			-15.2	-19.7	-20.5	-16.4	-13.1	-11.1	-10.3
Current account balance (c)			-6.3	-15.7	-16.4	-14.0	-10.6	-8.0	-6.5
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			-	-13.5	-15.0	-12.9	-9.5	-6.7	-5.1
General government balance (c)			-6.5	-6.4	-9.4	-15.4	-9.6	-7.4	-7.6
Cyclically-adjusted budget balance (c)			-6.5	-7.7	-10.5	-15.2	-7.4	-4.1	-4.7
Structural budget balance (c)			-	-7.5	-9.7	-14.2	-7.7	-6.3	-6.0
General government gross debt (c)			97.7	105.0	110.3	126.8	140.2	150.2	156.0

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

A lost decade after Euro-zone entry?

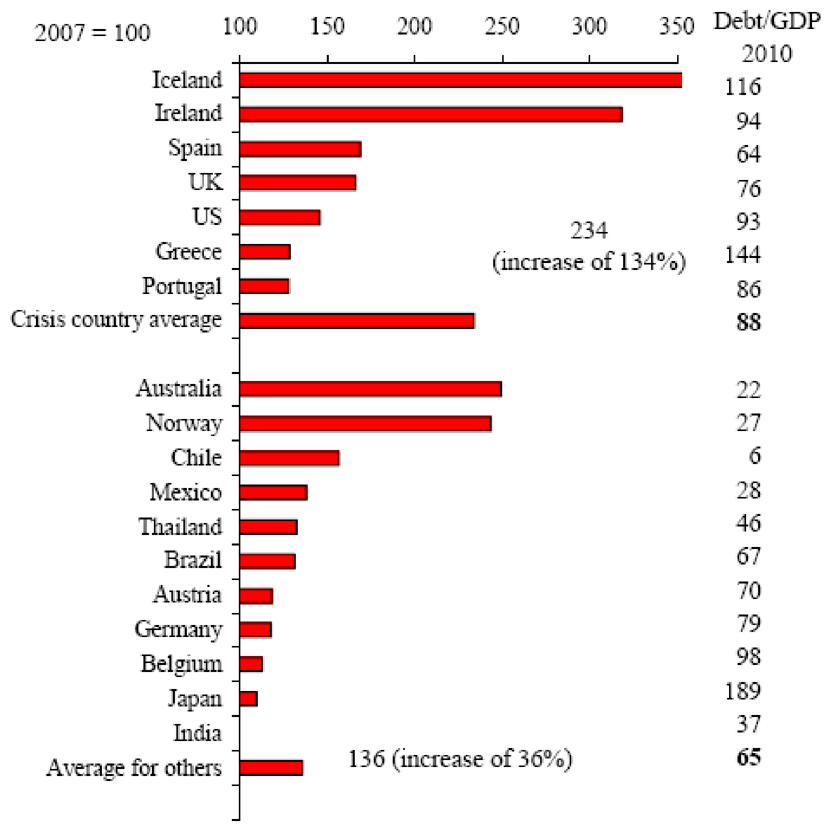
On the whole, policy performance during the last decade was disappointing. Fiscal deficits present a telling story. Greece has not run a balanced budget before and after the introduction of the Euro. The least deficit was -3,2% of GDP in 1999. Debt accumulation went on despite some attempts to bring it under control (see figure 1). The country accumulated debt more than any other member state of the euro zone and until 2009 neither "soft" pressure from the EU nor academic warnings seemed to be taken seriously.

Figure 1 : Greece. Accumulated debt 1996-2010. in billion Euros.



Greece's fiscal build up was part of a broader trend in advanced economies and that during the period 2007-2010 the increase in real terms of debt in Greece has been rather moderate when compared with what happened in many other countries such as Spain, United Kingdom and United States (see figure 2)[36]. Still, Greece was near default on its external debt in 2010and its problems seem to be more difficult to cope with. One reason is that the country already had accumulated high debts prior to the crisis and that fiscal profligacy for decades went hand in hand with diminishing competitiveness.

FIGURE 2. Cumulative Increase in Real Public Debt Since 2007, Selected Countries



Notes: Unless otherwise noted these figures are for central government debt deflated by consumer prices.
Sources: Prices and nominal GDP from International Monetary Fund, *World Economic Outlook*. For a complete listing of sources for government debt, see Reinhart and Rogoff (2009) and Reinhart (2010).

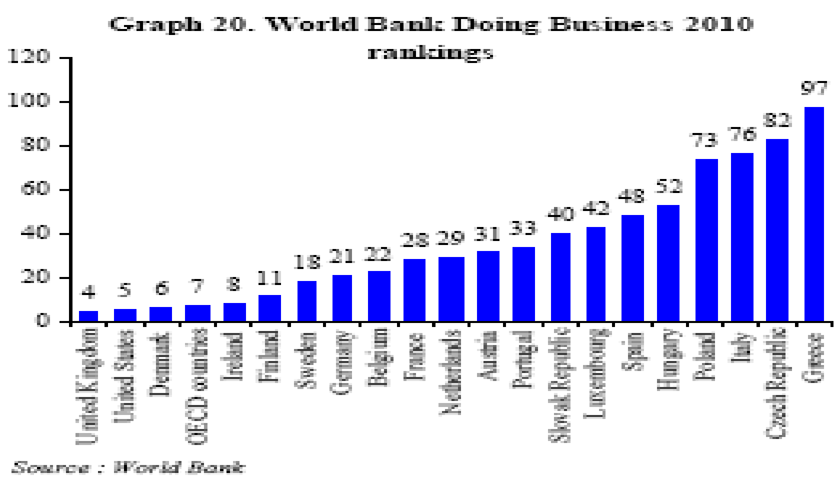
Source: Reinhart, Carmen and Rogoff, Keneth *A decade of debt*, CEPR, WP 8310, April 2011.

Greece allowed wages to increase much faster than productivity after 2000. Unit labor cost left all other countries of the eurozone far behind, thereby loosing competitiveness. Public sector wage formation set the tempo! Calculations by the Bank of Greece showed that unit labor cost increased between 2000 and 2008 by 28% against less than 2% in Germany[37]. Competitiveness declined constantly since the entry into the eurozone.

Greece also neglected long-term productivity and other structural aspects. Its production structure concentrated on relatively labor intensive sectors confronting competition from low wage countries. Innovation lagged behind. So, Greece saw a threatening build-up of external imbalances which reached levels of around 15% GDP. It became more and more apparent that policy choices were bad. A more fundamental rethink was urgently needed.

Again on the supply side, the country remained unattractive for foreign business trying to invest (see figure 3). There were and still are many reasons why this happens, from corruption and bureaucracy to the difficulties of obtaining secure property rights on land, impunity of corrupt corners in politics and administration and prevailing anti-liberal ideas. Successive conservative (2004-2009) and socialist governments (2000-2004, 2009-10) had realized all this had to be changed timely, but many reform designs remained on paper.

Figure 3. World Bank: Doing business 2010 rankings.



Wage formation in the pace setting public sector, inefficient use of resources by state authorities colluding with privileged firms, regulation protecting insiders and so on, all associated with rent-seeking games, went undisturbed on. At the same time other pathologies of the broader public sector became acute - bureaucratic chicanery, poor quality of public services (health, education etc) and corruption in an environment where none was brought to account and law was badly implemented. Throughout the ‘90s and 00s corruption appeared to thrive as International Transparency insisted[38].

All this made the country vulnerable to an eventual external shock.

The role of the EU.

It has been often argued that EU arrangements have worked as external inducements to reform[39]; that they increased “the state’s domestic capacity to act in relation to major problems of structural adjustment, by weakening the position of opponents of reform"[40], or convinced political elites and other domestic players of the legitimacy of liberal reforms.

Admittedly the influence of the EU explains repeated reform run-ups and some successes. Also, issues of fiscal discipline and liberal reform were put on the domestic agenda as a consequence of the institutionalized discourse and (soft) coordination in the EU. But this external inducement had limits before and after the introduction of Euro. Both medium-term stabilization programs (1985-87, 1991-93) agreed on IMF like conditionality terms (EU financial assistance on the condition that the Greek government implements an anti-inflationary policy package) have failed and were early abandoned. The *longer-term* convergence process cum reform in the 1990s turned out to be fragile and was reversed after the introduction of Euro. In the decades before and after EU-entry, stabilization and reform run-ups have been stalled or were quickly followed by setbacks (1987-90, 1993-1994) or periods of uncertainty (1995-1996 and, again, 2001-2004 and 2007-2009) due to the resilience of domestic factors (see below).

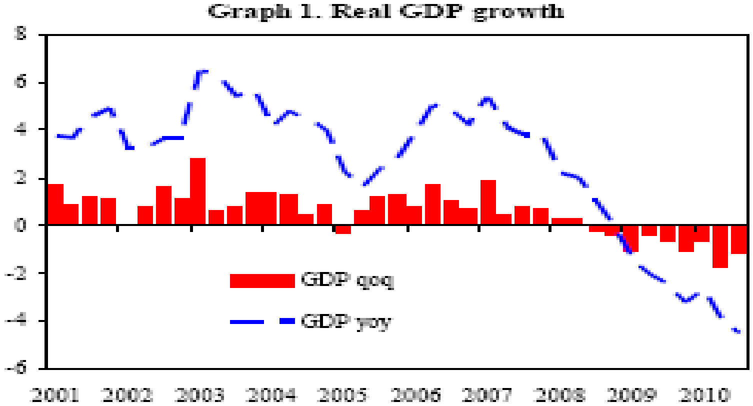
It is the debt crisis and deep recession in Greece, not EU coordination that seems to induce a decisive swift away from the institutions and practices of statism and rent-seeking. However, under conditions of crisis EU (and other international) arrangements regain force through an unprecedented policing of economic policy!

The outbreak of the debt crisis in 2010 and the EU/IMF rescue plan.

On October 5th 2009 the socialists returned to power after wining a landscape victory by promising to reverse the alleged austerity of the ND government. In fact the predecessors implemented strongly expansive fiscal policies in their efforts to stop recession. The socialists also promised to grant more social benefits, to re-nationalize privatized enterprises etc. "There is money" insisted G. Papandreou during the poll campaign. Naturally enough, the new socialist government announced new social expenditure, abandoned plans of the predecessor to increase revenues and imposed additional burdens to business (in the form of backdated "exceptional contributions" beyond normal taxation). The first Budget was based upon unrealistic growth assumptions and wishful thinking– as Commission and Council alike assessed. The rating firms began to lower their rating on Greek bonds. Despite some *late* efforts of the government to reduce deficits, the "spreads" climbed to high levels and made it impossible to refinance debts (see figures 5 and 6).

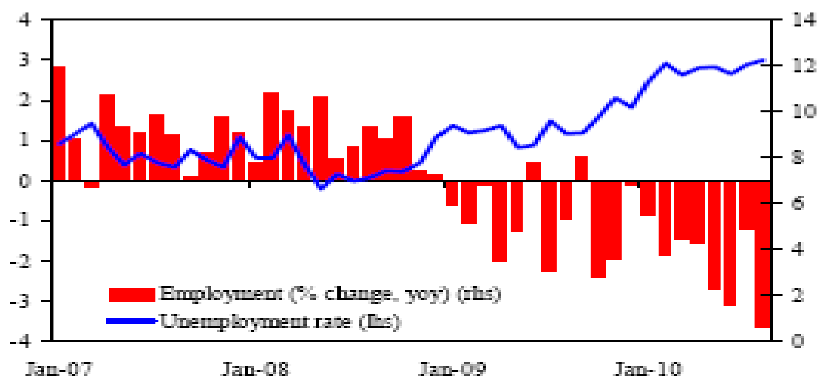
Figures 4a and 4b . Real GDP growth, employment and unemployment rate.

Graph 1. Real GDP growth



Source : EL.STAT.

Graph 2. Employment and unemployment rate

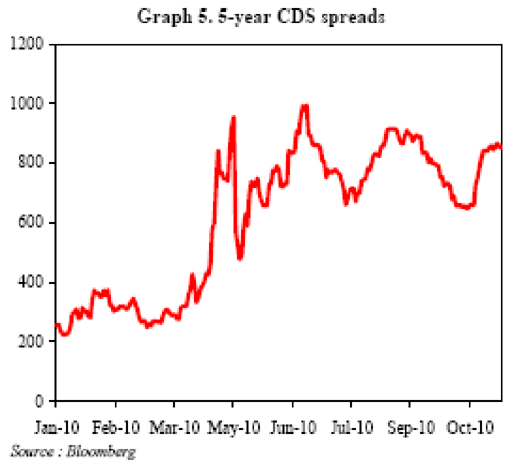


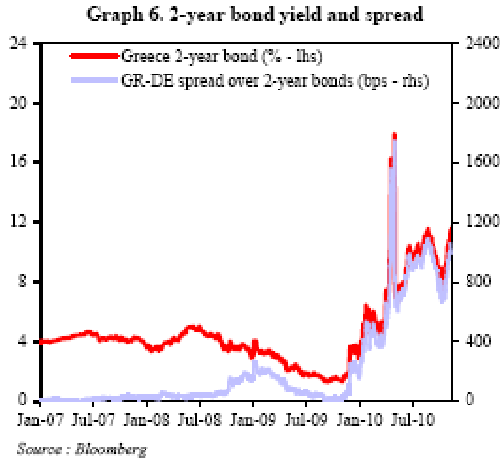
Source: EL.STAT.

Source:European Commission (2010)

In Spring 2010 Greece had no alternative but to seek help from the EU and the IMF and in May 2010 it became the first country in the eurozone to ask for a bail-out from the EU and the IMF. Ireland and Portugal followed. The international "arrangement" with IMF and EU rescued Greece from an outright and chaotically default. 30 billion euros were provided by the IMF and 80 billion by eurozone member states over a 3-4 years period. The amount was made available under the strict condition that Greece implements a three-year program based on the commitment to turn a large primary deficit into a large primary surplus. The program laid out a long list of expenditure cuts and structural reforms. It included radical tax changes, cuts in public-sector pay, labor market deregulation, other market opening measures (for example in the energy sector), privatization, and pension reforms[41].[9]

[9] All documents -the Memorandum of Economic and Financial Policies (MEFP), the Memorandum of Understanding on Specific Economic Policy Conditionality (MoU) and the Technical Memorandum of Understanding (TMU) are annexed to Greek Law 3845/2010.





The Agreement requires close reviews of the economic adjustment program for the quarterly disbursements of aid.

The three-year plan implied a radical change in the practices and institutions of governance and a radical re-orientation away from statism and pseudo-liberal arrangements towards liberal policies. The swift would predictably encounter resistance on the pact of all those profiting from the status quo. But the situation revealed some the deficiencies of the EMU regime[42].[10]

A serious defect of the fiscal austerity was that it did not rely as it should on expenditure cuts and trimming the state. Broader academic research and empirical evidence suggest that countries, relying primarily on cutting government expenditure rather than increasing tax revenues, are more successful in consolidating public finances and returning to growth[43]. Instead, a good part of the Greek austerity package concentrated in increasing direct and indirect tax rates. This proved to be self-defeating because it deepened recession and undermined the expected increase of tax revenues.

There is an explanation why the Greek government made this choice of instruments against academic warnings. It *links the choice of instruments with* broader rent-seeking and clientelism[44].[11] Politicians regard the public sector as a space to accommodate individual clients, organized interests, big business by targeted spending.

Because some targets of the adjustment plan have been missed (see below), the government presented in May 2011 a new medium-term (five-year) plan of fiscal reform and deficit-cutting measures to be implemented over the next years despite growing dissent inside the socialist party. In addition the plan included an ambitious programme of privatisations and state property sales worth 50 billion euros to be carried out over the 2012-2015 period.

[10] Early version of the theory of optimum currency areas implied (under certain assumptions) the centralization of a significant part of the national budgets, the establishment of automatic transfers in cases that some member states suffers a negative shock and, by extension, more "political integration". See inter alia discussion in Paul de Grauwe *The economics of monetary integration*, Oxford University Press, 1994. There is by now a rich but inconclusive debate about the link between monetary and political integration. Anyway the situation of the Euro-zone is unique since there is a shared currency without a state.

[11] K. Peven Arin, Viera Chmelarova, E.Fees and Ansgar Wohlscchlegel (2011) emphasize on the role of corrupt politics.

Doubtless, it is a positive step. However, to implement the real estate part of the program the government has first to create the necessary institutional structures for the development of real estate assets, which will be the basis of this amount. This may take much time if we consider legal problems in Greece and that privatization is not backed by a political consensus.

Assessing reform a year on.

One year on the results are again mixed[45]. It is true, the public deficit has been reduced by impressive 5 percentage points of the GDP which is generally considered to be a big step. But, the government (and the plan) originally had announced a deficit of under 9% for 2010. This has finally reached 10,5% of GDP and the deficit reduction this year (2011) may fail. It is in some distance from original targets. Because GDP decreased more than predicted in 2010 by 4,5 % and it is feared that it will fall by 3,5% in 2011, fiscal consolidation rendered more difficult than expected.

On the other side unit labour cost is already falling due to the recession. Internal devaluation seems to work. Exports are rising and tourism seems to profit from both wage restraint and widespread unrest in the Arab world. Further some useful reforms have been achieved after the agreement on the IMF/EU rescue package in May 2010. The government transformed the statistical service into an independent agency to cope with the credibility problem of its statistics, and passed a law concerning many services (layers, pharmacists, engineers, etc) and abolishing administrative prices and restricting market entry. Independent sources had calculated the benefits that opening the services markets could bring to Greece[46].

A major step in summer 2010 was the pensions reform. It included an adjustment of the parameters of the main pension funds[47]. The reform increased the retirement age, cut generous benefits to high income earners, simplified the highly fragmented pension system and established a new model combining a minimum "national pension" with characteristics of a capital based system. Preliminary studies showed that the reform has significantly reduced the projected increase in pension spending. To ensure further improvement the authorities will now cut entitlements in the funds for supplementary pensions.

Liberalization of labour markets has progressed somehow. In December 2010 the Parliament passed a bill on labour relations. The bill seemed to tackle a main impediment to flexibility by permitting wage negotiation at the level of the firms wage deviation from sector or general agreements.

The government has cut red-tape for new business. Parliament approved fast-track investment legislation simplifying procedures and accelerating deadlines for approval of strategic investment projects. Additionally the government eliminated legal barriers to the full operation of one-stop-shops in 2011. Now, it plans to create a unified public sector payroll in which dozens of discrete benefits handed out by various ministries over the past decades would be cut or streamlined, resulting in net civil servant salary reductions of 25 percent or more in some cases.

Resistance to many economic reforms and fiscal consolidation is once again strong with the result that implementation lags behind schedule. Overall, reform has been restrained (until mid 2011) despite progress in cases we have just outlined. In crucial sectors such as privatization, public services (health, tax authority other), opening of the energy market and liberalization of professions were swallow and their implementation poor or questionable. Even the bill that seemed to liberalize labour markets included several brakes to the implementation of the new rules, for example prior setting-up of a union in interested firms, monitoring agreements by a normally anti-business oriented Department of the central government etc. Equally, the services liberalization did not seem to work in practice until May 2011.

With time passing by, there is growing awareness that the adjustment task does not harmonize with the workings of the political system.

Explaining reform delays and fiscal consolidation problems.

As just briefly outlined, evidence indicates that reform in Greece has been often fragmented, incoherent and domestically negotiated rather than based on established wisdom. These characteristics invite to political economy explanations pointing to interest-based behavior, weak institutions, underlying norms and dominant ideas [48],[49],[50],[51], [52]. These factors, obeying to a logic of their own, prevailed at long last over European commitments and efficiency considerations.

Greece is indeed an obvious case for testing the relevance of the olsonian Hypothesis that stable societies tend to accumulate special interest organizations continuously, with the result that their impact upon economic policy formation becomes greater. Broad coalitions such as political parties and workers' federations become less able to adhere to more general interests. In times of change, necessary adjustments enhancing efficiency and promoting a flexible re-allocation of production factors are stalled, delayed or blurred. Influential interest groups (unions, business organizations, etc.) emerge as pro-status quo forces co-determining the potential for reform[53].[12]

In particular, we argue that political processes, if exposed to traditional clientelism in non-trust societies, as is the case in Greece, are more vulnerable to pressures from domestic forces pursuing short term distributional gains or defending diverse acquis. Traditional clientelism *increases the number of "veto players"* (to use a key-word coined by G. Tsebelis, properly re-defining it to embrace strong informal players and channels of influence) and this is negatively related to the potential for policy innovation and the political capacity to actively respond to external challenges[54]. Accenting to the top, clientelism may also be associated with government fragmentation, weak rule of law and other pathologies.

On several occasions, it has been argued that the role of the labour movement tends to be reduced in the present phase of European and global. This may be generally correct, but *public sector* unions retain enough capacity to influence government decisions. In Greece union membership has decreased in the private sector, but remained high in the public sector

[12] Mancur Olson (1982); see too Petrakis (2010) for an application of this theory to the Greek case.

throughout the period we deal with[55].[13] As providers of vital monopoly services, for example city transport, they can disturb painfully normal economic activities in the big cities of the country Athens and Thessalonica. Moreover, public sector unions dominate the General Confederation of Greek Labour. In 2001, 33 out of 45 members of the General Council of the Confederation came from public sector unions (public administration, public or publicly controlled economic enterprises, state banks). Most of them were also active members of political parties. Within the socialist party, they had built a strong and comparatively homogeneous power block that denounced any substantial reform as "neoliberal".

Indeed, they have a lot to defend. The public sector has achieved advantages far bigger than the private sector. Public sector employees earn, on average, a half more than their private-sector counterparts and enjoy "generous" advantages in terms of working time regulation, workload, paid holidays, accountability), pensions coupled with early retirement rules and many more. The unions oppose vigorously any move to more accountability. It has been almost impossible to discharge incompetent or corrupt employees. In 2007 Marietta Giannakou, the education minister in the last ND-government, lost her seat at the next election because she insisted on accountability for teachers and professors. Her predecessors shared the same experience.

Business interests, particularly those of construction firms and other big suppliers, are no less influential. Although the EU has intensified competition in many sectors, in some of them (e.g. construction, transport, energy) individual firms or entrepreneurial consortia have preserved privileged access to the state. The deals are often non transparent. Access is achieved through a combination of personal networks, control of mass media and ownership of popular sport clubs. Past changes of the law governing tenders to make it compatible with EU regulations do not seem to have changed much in the way the system works.

In Greece, it is not uncertainty that causes broad resistance to reforms or a broader *ex ante* societal bias against them, as it might generally be the case[56], but almost complete *certainty* about their distributional consequences. Reforms attack long established rents and rent-producing institutions and networks for political exchange.

Last but not least, ideological preferences are closely intermingled with clientelism and state-centrism in Greece (and elsewhere). They justify dominant practices. In Greece concepts like competition, transparency, flexibility, accountability, responsibility, employability, productivity etc have been demonized as neo-liberal devices, as Costas Simitis a former MP belatedly recognized[57]. A deep rooted anti-market bias is fuelled all the time by most mass media, which in turn work in an overblown sector and depend on external resources for survival.

However, most of these ideas and practices are now challenged.

The Greek government (as well as other governments) are being forced to cut back public spending, to halt debt accumulation, and to restore competitiveness. Public sector unions, professional associations in heavily protected and regulated activities, even individual big business enjoying privileged access to the government respond with repeated strikes and other actions against both, austerity and reform. But, due to the scale of the debt crisis and the threat of a chaotic default the pressure to consolidate public finances, to overhaul regulation and to increase efficiency, combat corruption and even insert the spirit of innovation in the

[13] 77.8% Union membership is in the public sector 77,8% , while average union participation in Greece is around 31.3% . See General Confederation of Greek labour *Wage earners and Unions in Greece (in Greek)*, Athens,

public sector is likely to continue in the future. A second wave of reforms is almost inevitable under conditions of crisis.

But, sustaining such a course demands political-institutional modernization[14] that might best serve the transition from a state-centered rent-seeking society into an open and competitive one.

1995, p. 2. Petraki-Kottis and Kottis (1997) gave lower figures.

[14] In Greece the new Constitution, finally adopted in 2001, did not come up with the broadly recognized need for innovative changes nor introduced any numerical rules to limit fiscal discretion of the government. It has rather broadened the scope for executive discretion and microeconomic rule-free interventionism in matters such as land use and environmental protection by restricting independent judicial control and by loosening strict provisions of the constitution. In a sense constitutional reform provided the parties with new domains to apply clientelistic practices, thus compensating them for the restrictions arising from EU rules and procedures. We call it 'the substitution effect". For the future George Tsebelis concept of veto players properly redefined may provide practical guidance. See George Tsebelis (2002).

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