Studying the political economy of reforms: The Greek case, 2010-2017

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Abstract. This article examines the recent experience of implementing the successive adjustment programs of the Greek economy over the period 2010-2017, in the light of the newer theoretical approaches of the political economy of reforms. Specifically, it attempts to interpret the persistent blockage of the Greek reform programs, to highlight discontinuities and binding constraints, as well as to explain the Greek economy performance.

Keywords: political economy of reforms, ownership of reforms, rent-seeking, political culture, economic fairness.

JEL Classification: E02, E71, H12, P52.
1. Introduction

After the post-war dominance of theories of economic planning in development economics (import substitution policies, etc.) and consequently in the economic policies pursued by the states, the emphasis was increasingly given to the neoclassical theories of development, which underlie policies to liberalize markets. Economic policy proposals, which were promoted by international financial institutions (IMF, etc.), were codified with the term Washington Consensus\(^{(1)}\) and include policy measures aimed inter alia at budgetary discipline, the direction of public spending towards high added value sectors, tax reform that gives development incentives, liberalization of the financial sector, liberalization of foreign trade, fixed exchange rates, attraction of foreign direct investment, competitive exchange rates, privatization of public enterprises, deregulation, legal protection of property rights (Williamson, 1989, 2004).

However, the adoption of these proposals has not been done in any case uninterruptedly. After all, the economy does not grow in a “vacuum”, but is embedded in the given institutional political environment. Consequently, the implementation of economic reforms is a highly political process insofar as the necessities of the economy interact with the objectives and priorities of state policy.

Thus, a common place of the various reform programs has almost always been their delayed introduction, poor implementation, or even their rejection, even where the agreement on their necessity was not in doubt. The reasons why the reforms that would theoretically improve the level of general prosperity are rejected and consequently how they can ultimately be realized, are the main research concern of the political reform economy.

The rich experience of Latin American, Eastern European and East Asian economies that followed reform programs led to a series of assumptions that make up constitute a guide for “technopols”, i.e. a proposed policy list for technocrats in positions of political responsibility and attempting to promote economic reforms (Williamson, 1994). Some of these proposals have been conceptualized the following theoretical assumptions:

- Reforms follow crises (the “crisis hypothesis”).
- Reforms must be implemented immediately after the elections (the “honeymoon hypothesis”).
- Reforms must be a part of the government's election program (the “mandate hypothesis”).
- The reform government should enjoy wide parliamentary support.
- Reforms are strengthened by the presence of a coherent group of economists in positions of political responsibility.
- The existence of a visionary political leadership with a vision that does not account for political costs is important.
- The existence of an analytical program of transforming the economy and its timely implementation is important.
The ability of government to communicate directly with citizens and to overcome special interests is crucial.

The losers of reforms must be compensated and the benefits for the winners must be realized.

The global financial crisis of 2008 found the Greek economy vulnerable (the “twin deficits” – fiscal and trade) and cut off from international financial markets, which led to an accelerated agreement with our European partners and the International Monetary Fund on a program Economic Adjustment (Memorandum I) that ensured the unimpeded financing of the public economy, and at the same time tried to tackle some of the chronic structural economic defects (it is characteristic that in the period 2000-2009, the competitiveness of the Greek economy declined to about 35%).

In the years of the economic crisis, Greece records significant institutional deficits in almost all indicators of good governance, such as public administration efficiency, property rights protection, accountability and transparency. The regulatory burden on business according to Lisbon Agenda, as well as the low degree of economic freedom in the country, is also indicative. In this context, the attempted reforms go beyond the objectives of economic modernization in terms of economic efficiency, and aim at transforming the dominant economic model of the country and moving to a different modus operandi of the economy that permeates every aspect of economic life and incorporates a different economic logic. In essence, the promoted reforms come together in a largely liberal economic program that attempts to address the “government failures” and the large number of institutional distortions in the economy.

Nevertheless, despite the widespread conviction of citizens about the necessity of introducing economic reforms, the agreed economic adjustment programs met with strong reactions that horizontally transformed the political system. This was an almost uncompromising rejection of all the reforms, as expressed by the results of the last elections, the short parliamentary terms, the number of protest movements, and culminated in the rejection referendum of July 2015.

History shows that the successful implementation of economic reform programs, both in terms of adoption and results, is far from assured. However, the intensity and extent of the rejection of the Greek program by the political body, particularly compared to other countries following economic adjustment programs, raises a number of interesting questions regarding the determinants of promoting economic reforms, in line with the theoretical policy approaches reform economy.

2. Do economic crises generate political change?

The Greek crisis and its effects seem to question one of the most well-known cases of the political economy of reforms, namely the “good crisis” hypothesis. According to the good crisis assumption, deterioration in economic conditions, and in particular a sudden
deterioration in public finances (Velasco, 1993), always precedes the introduction of reforms in an economy (Alesina and Drazen, 1991; Drazen and Grilli, 1993; Bates and Krueger, 1993). The increased pressures generated by the economic environment reinforce a sense of urgency and cause a process of reflection on the political leadership and the social body that leads to a change in the economic policy pursued. Empirical data seems to confirm this hypothesis in most cases as the depth of the economic downturn seems to be linked to the promotion of a series of structural reforms in OECD countries (OECD, 2012). In particular, there is a positive correlation between the primary balance of the states and the pace of fiscal adjustment of their economies. Indeed, the economies with the largest fiscal gap (Greece, Spain, and Portugal) recorded the highest response to the OECD Going for Growth Policy Priorities. Greece’s economic performance in the implementation of those agreed in the first six evaluations of Memorandum I was equivalent to Portugal’s performance and better than that of Ireland (Terzi, 2015). In trying to explain the successful advancement of the economic adjustment program in the early stages and the opposite of it, we put forward the following assumptions:

a) The conditionalities of Memorandum I largely concerned (horizontal) financial measures, the promotion of which is more technically feasible than the more complex “second generation” reforms (e.g. public administration reforms), or did not touch the core of the clientelist system (for example, regulations for closed professions).

b) The recession in which the Greek economy entered in 2008 had not yet been seen in the real economy and the reform program had not until then been linked to the negative social consequences of austerity policies. As noted, high inflation and the shadow economy at their extreme prices have a greater impact than the budget deficits (Drazen and Easterly, 2001) and macroeconomic figures that do not particularly concern the majority of citizens. Instead, the deep recession of the Greek economy, its subsequent social impact and the prolonged prolongation of the adjustment program led the social body to reform fatigue and to the identification of restrictive income policies with reforms that strengthened the overall rejection of the reform program (OECD, 2016).

c) The implementation of the economic adjustment program was favored by its rapid advancement in its initial stages, which confirms the crucial importance of the unexpected implementation of the reforms for their successful introduction (Sachs, 1994). This assumption takes into account political economy issues such as political credibility, or negatively (if the government seeks to avoid social reactions and the organization of opposing interests), or by its positive exploitation (in the case of the government's fresh popular mandate – the honeymoon hypothesis).

The initially dynamic pace of economic adjustment measures quickly slowed down mainly due to the unfavorable economic environment, the organization of opposing interests and the complexity of the reform program. It should be also pointed out that the distance between the formal adoption and the implementation of economic adjustment measures is in some cases significant. In the Greek case, this distance is important, which demonstrates the resistance to the promotion of the reform program. In particular, and
according to the OECD periodic report for Greece covering the period of Memoranda I and II (OECD, 2016), the country has comparatively the lowest rate of reform implementation among the countries that were implemented economic adjustment programs (Figure 1).

Figure 1. Reform implementation

The Greek case does not therefore verify the good crisis hypothesis. On the contrary, there is a negative correlation between the country’s economic performance and the social acceptance of the reform programs as throughout the period of economic adjustment there were persistently and increasingly negative high rates of public opinion towards the economic policies of the European Union. Greece presented all the basic characteristics of a “blocked society”, i.e. an organization where established interests or structural conservatism does not allow overcoming those obstacles (Giddens, 2007). The political body was extremely cautious about introducing economic reforms, although social disappointment was diffuse. It is characteristic that, in the period before the financial derailment, Greece was ranked among the more unhappy states in Europe.(4)

3. Reforms and institutional environment

The reluctance of a society to recognize institutional failure and to adopt a reform program is historically a common phenomenon. In all social agglomerations and organizations (governments, businesses, political parties, public services) inertia exercises a strong centripetal power. Institutional inertia is associated with a favorable status quo bias. The reproduction of an established structure shows the advantage of predictability and orientation of the action with relative security, against the inherent uncertainty of the new order of things. In fact, the majority of reforms are treated with extreme caution, which makes their implementation difficult.(5)
The cognitive limitations of the bounded rationality based on the information available determine the outcome of the decision-making process of individuals and groups under conditions of uncertainty and competition. Institutions are introduced to reduce the uncertainty in human transactions, and therefore every change implies increased reorientation of individual strategies. Institutional inertia carries “institutional path dependence” by encroaching on the action of individuals.

According to Douglass North (1992a):

*The process of change is overwhelmingly incremental [...] The reason is that the economies of scope, complementarities, and network externalities that arise from a given institutional matrix of formal rules, informal constraints, and enforcement characteristics will typically bias costs and benefits in favor of choices consistent with the existing framework. All else being equal, the larger the number of rule changes, the greater the number of losers and hence opposition.*

The observed institutional stability is not necessarily related to the effectiveness of institutional arrangements (North, 1992b). On the contrary, even where the best outcome of the future situation in terms of general well-being (Pareto) is widely accepted, individuals can reject it, as the impact on the individual level is not clearly defined. According to Rodrik (1996),

*The bottom line is that uncertainty about the consequences of reform at the level of the individual can prevent reform, even when it is recognized that reform will make a politically effective majority better off* (p. 37).

Institutional environment is shaped by the result of a continuous negotiation of painful political choices, a fragile balance between economic interests that in turn are in complex value, moral and ideological contexts and which are not necessarily compatible with each other. When in social competition there are distributional issues, individual interests compete with each other in order to get the most out of the benefits. The result is that the transition to the new situation is delayed (Alesina and Drazen, 1991).

The degree of social trust and its correlation with economic policy is of particular interest. In particular, it has been argued that in “low-trust” societies, citizens want state intervention even in cases where the government is ineffective (even corrupt). To the extent that the advanced adjustment programs are linked to “deregulation” of the markets and the withdrawal of the state from various areas of economic activity, it is considered that the reforms leave a “vacuum of power” that strengthens political uncertainty (Aghion et al., 2009). On the other hand, a surplus of social capital is positively correlated with the promotion of reform policies as the available social capital reduces transaction costs by facilitating the implementation of second generation reforms (Fukuyama, 2000). Consequently, the degree of political cohesion, and in particular the absence of political consensus, is linked to higher fiscal deficits and less effectiveness in the implementation of economic stabilization programs (Roubini and Sachs 1989).
Citizens' indifference to the importance and support of reform policies is exacerbated by their limited and asymmetric information on economic policy issues.

As pointed out in a classic model of political behavior (Downs, 1957), despite the fact that fuller information would generate greater overall benefits for citizens, from an individual point of view it seems rational to invest the minimum possible time in information and political process, as in some cases the cost of obtaining information (personal time, etc.) seems to outweigh the (uncertain) future benefits and certainly will not directly increase his income. Thus, the average citizen is presented as “rationally ignorant” (Olson, 2003).

The frequent phenomenon of economic illiteracy is still linked to the creation of a “fiscal illusion” in which individuals tend to overestimate future profits and underestimate future costs (Buckanan, 1967). A more specific form of fiscal illusion is “debt illusion”, in which the wrong estimation of individuals for the formation and servicing of public debt is greater if it comes from external borrowing than from the taxation of citizens. These phenomena lead political markets to operate far from the optimal effectiveness level.

Finally, for a more integrated approach to the decision-making of individuals in conditions of uncertainty, the theoretical processing of the social psychology sector is also useful. According to the cognitive dissonance theory, individuals tend to avoid the psychological discomfort caused by conflicting views (Festinger, 1957). So they often choose to ignore or filter the information available through complex psychological processes in order to match their established beliefs.

All of the above considerations can partly explain the blocking of reforms in the context of economic adjustment programs. Greece is historically a fragmented society. The low rate of social trust in the country seems to have exacerbated citizens' uncertainty over the attempted changes. According to the World Giving Index (2013), Greece ranks among the low-trust societies (135th among 160 countries in the ranking), based on the performance in civic participation in voluntary organizations, the provision of financial aid to charities and the assistance to strangers. To the extent that the emerging economic environment presented a high degree of uncertainty, the various social groups initially chose to wait and then sought to transfer the cost of economic adjustment to others acting on each other in a “war of attrition” that canceled or delayed a series of economic reforms (see Section 4).

It should not be overlooked that the revelation of the extent of the economic crisis and the agreement with international creditors has been unprecedented events for citizens. Although the worsening of public finances has long been known (in April 2009 the Greek economy was placed under the “excessive deficit procedure” under Article 126 of the EU), the long-term unhampered economic growth which has created a positive climate, the reassuring stance of a large number of political personnel and the usual indifference of public opinion on economic policy issues have been misleading and, in any case, did not facilitated the necessary reflection to overcome the crisis. However, according to the mandate hypothesis, the policies of a newly-elected government should be clarified at a
programmatic level, especially in cases where society is fragmented, of strong interest groups and of unpopular reforms (Keeler, 1993).

The phenomenon of cognitive discrepancy was largely observed in the early stages of economic adjustment (Memorandum I) when in 2011 the gatherings of the “indignant” flooded the great Greek cities. In public opinion surveys at that time, respondents at a rate of up to 40% appeared to welcome expressions of condemnation to political figures (ALCO, 2011). The participants willingly adopted and largely irrational concepts that were not verified by political and economic reality. The common denominator of the different demands put forward by the “indignant” was the absence of a fundamentally coherent political discourse, rational arguments and realistic proposals (among them the shift of responsibility of the economic crisis to the political personnel and the dictation of the program of adjustment from, apparently or secretly, domestic or foreign decision centers). The anti-political attitude of the indignation movement strengthened the aggressive discourse of the ideological populism of that period, shortening political communication, minimizing the chances of internal political negotiation and reaching a consensus to exit the crisis, and ultimately contributing to the failure of the economic adjustment program.

Finally, the possibility of bypassing institutional arrangements by citizens and choosing other social arrangements that resolve institutional rigidities and failures leads paradoxically to their stability. An explanation of this phenomenon was given by Albert Hirschman, who introduced the concepts of “voice” and “exit” as the main categories of manifestation of the dissatisfaction of citizens and consumers with the inefficiency of organizations and enterprises (Hirschman, 1972). Consumers complain or choose other products. Voters protest or transfer their support to other political formations. Hirschman illustrates the example of Nigeria where the proverbial delays in the railway services provided did not lead to their improvement but instead to the strengthening of the road transport network. In this case, the existence of a competitor did not improve the performance of the railways, as the consumer’s withdrawal capability (“exit”), combined with the (disconnected from the principle of efficiency) public funding, undermined any pressure for change (“voice”).

In the Greek case, in the period before the crisis, citizens choose to exit instead of voice, leaving arteriosclerotic and economically ineffective institutions intact. For example, domestic private health spending has, along with Chile and Mexico, been the highest in the OECD. Respectively in tertiary education, the withdrawal of citizens was expressed by fleeing for study abroad or by private colleges. However in the Memorandum period, blockage in the implementation of institutional reforms was observed alongside the strengthening of extra-institutional choices, such as the shadow economy.

4. Rent-seeking and reforms

One of the features of modern democratic capitalist systems is the increased influence of organized special interests (Olson, 2007). A large number of special economic interests
are organized into “distributive coalitions” and compete with each other to obtain the greatest possible revenue. Their rent-seeking behavior distorts economic markets and leads to “state capture”, i.e. the formulation of the regulatory/institutional economic framework that serves their interests (Stigler, 1971). The uninterrupted dominance of special interests for a long time strengthens their transformation into vested interests, which in turn lead to the “institutional sclerosis” the political-economic system by preventing any change that could question their interests.

In any case, the balance between rent-seeking groups is not unchangeable. In times of economic growth (where there is a wealth of available economic benefits), pressure groups often opt for a mutually beneficial “cohabitation equilibrium” that creates a powerful political alliance that opposes any change (Tornell, 1995). This may explain why reforms are not being introduced at times when the economic environment is favorable. On the contrary, in times when the economic environment is unfavorable and economic rewards are limited, rent-seeking groups step up their competitions and engage in a war of wear and tear in order to shift economic burdens to others (Alesina and Drazen, 1991). Indeed, even if the late implementation of an adjustment program leads to increased financial burdens as the economic conditions deteriorate, rent-seeking groups prefer to be obstructed to the extent that burden sharing appears disproportionate and do not know the political strengths of other groups (Alesina and Perotti, 1994). In addition, the bigger number of pressure groups makes the implementation of the reform program more difficult. However, in general the onset of an economic crisis leads to the disturbance of the symbiotic balance between the associative groups, which favor the promotion of the reform program. For example, in Mexico in the 1970s, the two prominent rent-seeking groups (the private sector that competed with imports and the wider public sector) blocked the liberalization of Mexican foreign trade, but when the early 1980s collapsed public revenues, have fueled intense competition that has led to the support of reform policies (Tornell, 1995).

To what extent is it possible to overcome the resistance of strong interest groups? The interests of rent-seeking groups are usually treated as fixed and unchanged. As a result, governments that implement economic adjustment programs choose, depending on their bargaining power, their weakening or frontal collision (which increases the political costs of reforms sharply). However, a more effective implementation of a reform agenda is achieved through the development of coalition building, the organization of support for the reform agenda by the “winners” of change, and the compensation of the “losers” of reforms (see Section 5).

Therefore, consultation with special interest groups willing to reach a consensus on promoted change should not be ruled out. Institutionally representation of labor is often the basis of the desired compromise. Even in the case of strong labor unions (which are usually affected by austerity economic policies), the scope for conciliation, at least in the early stages of economic adjustment, is significant (Haggard and Webb, 1994). This phenomenon was observed in Poland where the powerful trade union Solidarity
Movement supported the first reform program of the government of Tadeusz Mazowiecki, who himself had also been a member of the trade union (Lehmann, 2012). Indeed, the simultaneous presence of center-left governments seems to facilitate dialogue with trade unions, as they are considered to enjoy greater credibility among them (as observed in Spain for example between 1982 and 1986 with the Socialist Government of Felipe Gonzalez). In the case of business special interest groups (that usually react to the “opening up” of markets), complementary policies in product markets (e.g., export promotion actions) can act as a counterbalance to reaching consensus.

In the Greek case, the dominance of organized interest groups in the Greek economic system is catalytic and determines the character of clientelist relations. In this environment, the Greek political and economic system is “porous”, facilitating its fallout from the diverse special interest groups. The domestic economic model is described by the term “kleptocratic microcapitalism”, an economic model where the economic behavior of numerous rent-seeking groups is likened to the Viking raids (Mitsopoulos and Pelagidis, 2009). Based on this approach, markets in Greece are throttled between a hypertrophic “octopus state” that interferes with the functioning of the markets through the gigantism of public enterprises and through administrative acts of the “order and control” type and in a cluster of pressure groups that engage in a constant search for rents by participating in a network of “trading favors”.

Probably expected, the attempted reforms at the microeconomic level encountered the strong reaction of numerous and politically organized “veto players”, of whom the cost of the changes was high. Successive governments have failed to reach any consensus with organized interest groups, choosing either the frontal conflict through the sudden introduction of reforms or their (detrimental) postponement. However, in the first stages of the economic adjustment program implementation, at least in the part of the macroeconomic adjustment measures, the presence of fewer veto players has significantly facilitated the achievement of its objectives.

5. The distribution of economic adjustment costs

By definition, a reform program involves transition costs. It breaks down established economic relations and interests and redistributes financial resources and revenues. Insofar as reforms are aimed at increasing economic efficiency and are delivering in the medium and long term, social groups and governments are often asked to cross the “valley of tears” where adaptation costs are significant.

Failure to compensate the losers of reforms explains their rejection even where they increase economic efficiency, especially when governments cannot make credible commitments to their future compensation (Roland, 2000). The adjustment program implementation procedure intensifies the competition among the social groups in order to minimize the costs they have to pay. However, issues of fairness and redistribution are unjustifiably absent, although the correlation between social cohesion and political trust has been highlighted.
Consequently, the increased economic and social inequality is correlated with greater mistrust for government purposes as well as with increased support for social groups towards redistribution policies (Rodrik, 1998). It has also been observed that the effectiveness of social transfers to addressing poverty and supporting the weaker social groups has a decisive impact on the successful implementation of an economic adjustment program (Kaplanoglou et al., 2013).

In the Greek case, the economic crisis has revealed a multitude of structural lags that forced the introduction of deep, large-scale and numerous reforms, which were essentially of a systemic character. Nevertheless, in the years of economic adjustment the issues of economic inequality were largely ignored. The increased social protection needs during the recession were not addressed effectively, and the importance of inequality in the social environment and its impact on citizens’ attitudes towards reform programs was underestimated.

It is commonplace in times of economic recession to increase social spending as a percentage of GDP in order to address the increased social protection needs. However, this did not happen in the Greek case. Social spending as a share of GDP declined, as opposed to the neighboring countries of Italy, Spain and Portugal, where social protection expenditure increased to mitigate the social consequences of the economic crisis (OECD, 2014):

Thus, the restrictive fiscal policies followed in conjunction with the ineffectiveness of the social protection system failed to mitigate the social repercussions of the recession. Worse, the policies implemented multiplied the negative impact of the economic crisis on income distribution, disproportionately affecting the most vulnerable groups of the population and creating a “new social issue” (Matsagganis, 2013). In the period 2010-2013 indicators of income inequality and relative poverty were skyrocketed (OECD, 2016): 

Graph 2. Economic inequality and relative poverty in Greece (2008-2014)

Beyond that, the burden of economic adaptation between different social groups proved to be politically unbalanced and socially unfair. According to Giannitsis and Zografakis (2015), during the crisis years and the subsequent implementation of the stabilization programs, new social divisions emerged between: a) the “insiders” and the outsiders of the labor market; b) those who normally pay the taxes to those who don’t; (c) those who have been able, because of their increased political influence, to recover part of the income; (d) those who have improved their relative financial position during the crisis (mainly through the distorted tax policy) and those who did not.

Ultimately, the sudden deterioration in the living conditions of the people, the inefficient social protection system, the unequal distribution of adaptation costs and the indifference to “forgotten groups” which are suffering silently because they are politically disorganized (Olson, 2002), have worsened the social consequences of the crisis, highlighted issues of social justice, delayed economic recovery and, in the end reinforced the rejection of reform programs as people questioned their credibility.

On the contrary, diffusion of the benefits of the reforms implemented to large social groups and the operation of a targeted social protection system increase both the prospects for the success of the adjustment program and the chances of re-election of the reforming governments (Buti et al., 2014).
6. The design of the reform program

International experience suggests that the initial conditions affect the depth of an economic downturn (Krueger and Ciolko, 1998). At the same time, modern empirical studies show that weak economic institutions are ahead of economic crises. In these cases, economic recovery is delaying further (Bluhm et al., 2013).

The combination of these two phenomena was observed in the case of the Greek economic crisis management. The authors of the first and the second economic adjustment programs seem to have underestimated the duration and depth of the economic recession and at the same time overestimated the economic impact of the reforms. It is really striking that the discrepancy between the assumptions of the first two Memoranda on GDP growth and the actual performance of the economy (European Commission, 2015):

Graph 3. Actual GDP and basic programmes assumptions (Memoranda I & II)

In the Greek case, the fiscal multipliers (i.e. the effect of the deficit reduction on GDP) were different than expected, as the contraction of the economy was significantly higher than the projected (Blanchard and Leigh, 2013).

The fiscal adjustment programs seem to have underestimated the effect of Keynesian multipliers on the basis of factors such as low savings, low tax returns and low volume of trade (Alcidi and Gros, 2012). Indeed, the limited production base of the Greek economy did not allow domestic devaluation to contribute to improving production as the resources saved did not have any way to divert and eventually reduced (the already limited) aggregate demand. On the other hand, domestic devaluation in export-oriented economies led to an improvement in their trade balance and an increase in their exports, while absorbing shocks from a reduction in domestic demand (for example, in 2007-2013 Spain increased its exports 25% more than Germany, while imports declined only 11%). In Greece, the policies of internal devaluation (wage cuts of more than 20%) did not lead to a substantial strengthening of Greek competitiveness as its introverted economy could not benefit. Greece was the only country that showed a negative export index compared to the pre-crisis period (Alcidi and Gros, 2012).
The designers of the Greek economic adjustment programs have overestimated the positive effects of structural reforms and their performance time (IMF, 2017). Economic reforms rarely yield in the short term (Bouis et al., 2012), while their fragmented implementation weakens their impact (in the case of Greece, labor market reforms were not supported by the corresponding reforms in product and service markets). In addition, the role of appropriate supportive policies (e.g. credit expansion, tax policy) is crucial. Economic growth is rarely realized in the absence of adequate bank credit. However, since the onset of the economic crisis, the Greek economy has been on the path of an “unfinanced recovery” (PwC, 2017). This is an unpleasant phenomenon because the unfinanced recovery amounts to 1/3 of the funded growth and happens in only one out of five times.

Furthermore, growth must be supported by an appropriate fiscal policy. Tax increases hampers growth more than spending cuts (IMF, 2010), and especially corporate tax increases have a greater impact than other forms of taxation (OECD, 2008). The limited tax base of the country in the pre-crisis period and the particularly low tax revenues, coupled with the necessity of immediate refinancing of public finances, have led to an increase in tax burdens. However, the sharp and steadily rising and excessive growths of (direct and indirect) taxation in a recession as well as its socially uneven implementation have had a negative impact on the recovery of the economy and the program effectiveness. Moreover, the unpredictable levels of external public debt kept the Grexit debate extremely worrisome for the recovery, but also negatively affected the Greek economy growth. According to a study on European economies, public debt levels above 95% of GDP have a negative impact on growth (Baum et al., 2013). However, in the early stages of the crisis and the implementation of the program, creditors in order to avoid the “moral hazard problem” in the Eurozone imposed high borrowing rates on Greece and rejected any discussion of a (necessary) debt reduction (Sachs, 2015).

The economic objectives that were set were far too ambitious as they required a fiscal adjustment of such a size that could not be supported by the dynamics of the Greek economy or by international experience. A similar extent of fiscal adjustment was achieved only by Israel, under specific circumstances. A similar mistake is repeated today with the obligation to achieve high primary surpluses (3.5% for the years 2018-2022 and 2% for the long period 2023-2060.) High primary surpluses (especially when relying on excessive taxation of the factors of production) are recessive as they deprive the necessary budgetary space, thus undermining the long-term growth and the objective of the debt reduction. It is typical that among 121 cases of fiscal adjustment recorded in the period 1974-2013, maintaining primary surplus of more than 4% over ten years’ time became possible in five of these (Eichengreen and Panizza, 2014). The fiscal adjustment policy “mix” has been counter-productive, as the objective of raising tax revenues instead of limiting public spending, especially in times of recession, reduces production capacity and has a negative impact on investment (Alesina et al., 2012).

In addition to the above, the design of the Greek reform programs seemed to treat basic political economy factors as external variables when we know that they are largely
attributed to the successful or non-implementation of an economic adjustment program (Ivanova et al., 2003). The diversity and the different functioning of political systems explain why similar economic policies yield different results.

In a similar way to the social body, the phenomenon of cognitive disagreement was presented among the designers of the Greek economic adjustment program. The reluctance of the Institutions (the European Commission, the European Central Bank and the IMF) to assess the immediate results of the policies pursued and their persistence in the correctness of the plan (“things will worsen before they get better”) did not allow the necessary adaptation of the program to economic environment.

A decisive factor in the effective implementation of a reform program is the “ownership of reforms”, i.e. the ownership of the political system on the promoted policies (Johnson, 2005). The ownership of the reform efforts, not only by the political class but also by the people, facilitates their introduction and enhances their performance:

*Government ownership is at its strongest when the political leadership and its advisers, with broad support among agencies of state and civil society, decide of their own volition that policy changes are desirable, choose what these changes should be and when they should be introduced, and where these changes become built into parameters of policy and administration which are generally accepted as desirable* (Killick et al., 1998).

On the contrary, when the ownership of reforms is absent (and even more so when the reform program ignores the particular conditions and balances of the political system) any failure in its implementation challenges its effectiveness. Doubts about the correctness of the reforms being promoted are increasing when the reform program appears guided by the external factor and the political leadership are not credible (Stiglitz, 2000). When an adaptation program fails, having previously grown overwhelming expectations, and when hostility to the outside agent is dominated by the domestic political system, results are often worse than would be the absence of any program (Haggard and Webb, 1993). In the case of the Greek adjustment program, the limited involvement of the government in the formulation of its content has increased the question of the correctness of the policies pursued.

In the absence of a social consensus on the implementation of a reform program, the strategies chosen for its promotion are of particular importance. Although their goals remain the same, the two key strategies for promoting economic reforms are radically different in their approach. The first (and more common on the basis of international experience) is the rapid implementation of the proposed reforms, aiming to take advantage of the window of opportunity offered either by the government's fresh mandate or the surprise of the organized interest groups (the blitzkrieg tactic) where changes are introduced into the political organization as a “bitter pill”. This strategy avoids the reform fatigue usually accompanying long-term adjustment programs leading sometimes to their abandonment (as in the case of Hungary in 2001). The Polish post-communist transition to a market economy is often referred to as the most successful example of a “big-bang”.
Leszek Balcerowitz, the architect of the adjustment program, explained the logic of the policy:

*First, I was aware that the political breakthrough in Poland had opened the way for a brief period of what I called “extraordinary politics, when it is easier than during normal times to push through difficult reforms”. Implementing a radical economic strategy made the best use of this gift of history. Second, people often grudgingly change their behavior if they see a radical change in the environment they face and think that change is irreversible.* (Balcerowitz, 2014, p. 25)

In other cases, the reform shock therapy did not yield the expected results, as in Russia, where the program implementation resulted in the state capture by the so-called “oligarchs” (Goldman, 2003). Consequently, the issue of the extent of the reforms under way, i.e. the number of areas of action of the adjustment program, is crucial. The designers of the unprecedented promotion of the reform programs also seem to share the “synergy illusion” (Hirschman, 1991) as they see that reforms are cumulative and their combined implementation maximizing economic outcomes. However, reforms often operate in a competitive or even subversive manner, as is the case, for example, where budgetary policy does not support growth policies.

The second strategy follows the evolutionary/institutionalist approach, which focuses on the role of information in the economic process (Murrell, 1992). An evolutionary and gradualist implementation reform strategy (both at the time of its introduction and to the extent of changes) allows social alliances to be built and political support to be mobilized (especially when the first reforms start to deliver), helps to the necessary program adjustments, and to the mitigation of negative economic effects. A carefully designed and progressively implemented economic adjustment program reduces the inherent uncertainty of citizens about the implications of the program and increases their confidence in political leadership. The risk of organizing opposing interests in the time of the gradual introduction of change is balanced by the appropriate “sequencing of reforms” (Wei, 1997). At the same time, the gradual promotion of reforms allows the government to weaken organized interests through a “divide-and-rule” strategy (Roland, 2000). Finally, researchers have highlighted the importance of having an administrative organization capable of supporting the implementation of the reform agenda, which concerns not only the public administration structures but also its staff (Shleifer, 1997).

In fact, implementing a reform program is an extremely complex process determined by the issue of time inconsistency as the preferences, aspirations and interests of individuals change over time, and ultimately, to a greater or lesser extent, a gradual adaptation model (Przeworski, 1991).

In the case of the first Greek economic adjustment program (Memorandum I) and under the pressure of sovereign default, a strategy of immediate implementation in a broad area of reforms (labor markets, “closed professions”, etc.). However, the implementation of
the reform program was done in an unequal manner. Thus, deregulation in labor markets has consequently weakened social support for reforms, while reforms in product markets, which could lead to higher employment and lower prices, have not been sufficiently promoted. In Portugal, on the other hand, product market reforms that have increased consumer disposable income were preceded by labor market reforms. And of course, the forward and tough fiscal program that preceded formed a difficult economic and social environment for reforms. A different set of measures (a primary surplus of no more than 1.5% of GDP, a mild pension reform, initial product market reforms, and policies to support small and medium-sized enterprises) could have produced better results (Manasse, 2015).

The sequencing of Memorandum I reforms deepened the economic recession and increased unemployment while at the same time there were no reforms that could bring forward benefits to large-scale social groups (e.g. measures to boost youth entrepreneurship) to facilitate social consensus (Haliassos, 2015). Still, some of the promoted policies were conflicting, limiting their potential benefits. For example, the expected improvement in industrial competitiveness from the deregulation of labor relations has been curtailed by the simultaneous increase in energy costs for industrial enterprises. Similarly, in the context of Memorandum III, the sharp increase in the tax burden eliminates the scope of growth policies.

Finally, the institutional/administrative deficiencies of the Greek state (which intensified during the crisis) made it difficult to implement the reform agenda (Rapanos and Kaplanoglou, 2014). The ineffective justice system impedes the performance of economic reforms as Greece is ranked the last among 18 EU member states. (EU Justice Scoreboard 2014). Excessive corruption has also a negative effect on GDP and the attraction of foreign direct investment (Johnson et al., 1998), an indicator in which Greece also appears to be subdued in the years of the crisis. The institutional reconstruction of the country should therefore be preceded or even run in parallel, by economic reforms.

7. The importance of credible political leadership

A large part of the political economy of reforms literature seems to degrade the “voodoo politics” strategy and instead highlight the importance of having a political leadership that is capable of maintaining open communication channels with society throughout the implementation period of the adjustment program (Williamson, 1994). As a reform program usually extends over a significant period of time (“the valley of transition”), it is important to prevent fatigue, derailment or even abandoning the reform effort (Przeworski, 1991). In this case, the government's ability to make credible commitments is important. Even more so, in cases where the government does not have the necessary credibility, a gradual implementation of the reform agenda helps to build trust with the people (Xinghai, 1992). Moreover, the existence of a credible and determined political leadership is able to fill the institutional deficiencies (Wallis and Dollery, 1999).
The credibility of political leadership can also overcome ideological constraints, as the reformed reforms are seen as necessary and do not serve political considerations (Cukierman and Tommasi, 1995). Conservative economic adjustment programs are often successfully supported by “left” governments. A typical example was the reform agenda of Carlos Menem in Argentina or relatively recently of the Brazilian Labor Party under the leadership of the radical Socialist Lula da Silva.

The credibility of reform policy is also linked to its ownership by political leadership (Section 6). The intellectual agreement between policymakers on diagnosing the problem and its causes and the appropriate policies to address them is necessary for the credible implementation of a reform strategy (Johnson and Wasty, 1993).

In the case of the Greek adjustment program, the low credibility of the political system (as recorded over time in public opinion surveys) undermined the successful implementation of the reformed reforms from the outset. There has never been a guiding reformist political coalition, and successive governments have argued for the necessary acceptance of the program only under the pressure of the country's creditors, while there was an explicit or conjectural claim that the content of the reform measures was dictated by the creditors (“Troika”). It is indicative that, since the onset of the crisis and the adjustment program, successive governments have avoided or failed to draw up a national growth strategy despite the existence of the relevant obligation.

8. Conclusions

The study of key assumptions of the political economy of reforms demonstrates critical dimensions of the implementation process of the Greek adjustment program for the period 2010-2017. The economic adjustment program was accepted with particular caution by an uninformed, politically distant and ideologically hostile public opinion. The design of the reform program did not take into account to the required extent the economic and social environment, as the frontloading of a strong fiscal adjustment and the absence of adequate supportive social policies deepened the recession and sharpened social contrasts. The organized interest groups have been numerous and powerful while there was no reliable reformist political coalition claiming the ownership of change and capable of guiding the implementation of the program. Under these circumstances, the resistances, delays and retreats recorded during the implementation period of the adjustment program were explicable and rather expected.

To the extent that the apparent conclusion of the current adjustment program (Memorandum III) does not mark the end of the reform efforts for the definitive reshuffle of the Greek economy and society, the lessons learned would be helpful in contributing to the future shaping of reform policies. The appropriate planning of the future reform policies and their effective implementation should integrate key issues of the political economy (resource allocation, political antagonisms, and social perceptions) as endogenous variables in the dynamic system of the Greek economy. An economic
adjustment program has little chance of achieving its targets unless it succeeds to balance the multitude of opposing economic interests and integrate them into a politically coherent reform plan that equites the burden of adaptation by achieving a high degree of political and social consensus.

Notes

(1) Initially, ten economic policy proposals were made to the Latin American developing countries in order to cope with the economic crisis, which garnered the consensus of the international economic organizations based in Washington, which were recorded in 1989 by British economist John Williamson. In the following years, the initial proposals were supplemented by a number of others, mainly concerning institutional (or second generation) reforms (Williamson, 2003), and others such as the design of industrial policy aimed at developing a national innovation system.

(2) According to The Heritage Foundation's Index of Economic Freedom for 2015, Greece ranks 130th among 178 states (mostly unfree).

(3) The Greek economy lost 25% of its GDP in the period 2010-2016, the unemployed reached 1.35 million and 1/3 of Greek citizens were below the poverty line (= annual income below 4,608 €).

(4) The typology of the “happy model of capitalism” follows the approach of prosperity economies and classifies countries on the basis of the achievement of ten measurable indicators, including: low unemployment, low corruption, high levels of social trust, and high level of education, high income, limited shadow economy (Deutsche Bank, 2007).

(5) It has been observed that about 70% of major sectoral reforms fail (Kotter, 2001).

(6) Citizens' indifference to public debt is potentially politically desirable, as it conceals an intergenerational redistribution by transferring costs to future generations (Cukierman and Meltzer, 1989).

(7) According to Ernest Gellner's definition, fragmented society is at the opposite of civil society.

(8) A similar phenomenon was observed at the same time in the case of the Spanish indignant (“los indignados”).

(9) Former German finance minister B. Schauble, at a previous meeting of the European Parliament's Committee on Economic and Monetary Affairs, compared the transformation of the Greek economy with the transition of the former Eastern bloc countries to market economies.

(10) Households with children without any worker are the new social issue of the country.

(11) The failure of the estimated multipliers was also observed in other countries' adjustment programs. In particular, the multiplier ranged between 0.9 and 1.7 instead of the predicted 0.5. In Greece, the nominal GDP of 2013 and 2015 was 12% and 20% lower than the original projections.
This case is described as “Nixon goes to China”, since only a US foreign policy “hawk” such as the American president could visit the rival communist China (1972) without harming its political credibility.

According to the Third Memorandum of Understanding text, “Greece needs to build upon the agreed recovery strategy and develop a genuine growth strategy which is Greek-owned and Greek-led” (p. 5).

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