

The fiscal crisis of the Greek Economy

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The fiscal question until 1974

Up to 1974, during the long period of economic growth that was initiated in the mid-1950s and lasted until the end of the 1970s, the Greek economy had a relatively small state budget. Public expenses constituted something in the range of 25 % of the GDP for almost three decades. Public expenditure was absorbed by a modest public administration, high military expenses and a very basic welfare state. Yet the state had a much more central role in the economy, through the extensive state-ownership in the banking, energy, telecommunication and infrastructure sectors.

Greece was part of the Bretton Woods system. It had more or less balanced budgets and a drachma fixed to the dollar. The permanent trade deficit was financed by migrants' remittances and income from the booming shipping industry. The high rates of economic growth were sustained by a combination of foreign and local investment in industry, modernization of agriculture and public investments in infrastructure. In addition the massive urbanization of this period was related to an impressive generation of savings and investments in construction, a process that did not involve the banks.

In effect the fiscal arrangements were related to the credit arrangements. The taxation system was based on indirect taxation, that is consumption taxes and other receipts. Two thirds of tax receipts belonged to this category. Income taxes were drawn mainly from waged and salaried strata. Thus business activities of all sorts, contributed less than 10 % of the tax receipts. For decades business activity, was identified with tax evasion, either legal or illegal, in most cases legal.

The farmers, then being over half of the population, were excluded from direct taxation. In addition the industrial sector that was receiving state subsidies and enjoyed tariff protection in order to develop, had also favorable tax arrangements. Finally the commercial middle classes that had been excluded from credit, as all credit was absorbed by industry, agriculture and infrastructure, were allowed to practice »tax evasion«.

Thus the strategy of »economic growth at any cost« was accompanied by a very specific system of fiscal arrangements that were related to the priorities of the credit system and included a peculiar type of »social compromise«. The state supported certain sectors, and compensated the rest by allowing »tax evasion«. The waged and salaried classes paid a modest income tax plus the consumption taxes, but at the same time they were better off than the masses of migrants moving abroad. The taxation system was »anti-progressive«, as it had no redistributive function. Yet the question of »social equality« was undermined by the priorities of »economic growth«. In any case the political regime of the authoritarian Right and the dictatorship thereafter had little concern for a social agenda.

The expansion of the state in the 1980s

By 1973 the Bretton Woods had collapsed, modest inflation was back and the drachma became once more an unstable currency. It coincided with the return to democracy in 1974.

Then the state started to expand. Initially it was the conservative governments of the New Democracy (1974–1981), that started to nationalize private companies that were under stress due to the international economic crisis and the staginflation. This included the aviation sector, the shipyards, part of the private banking sector and a whole range of industrial establishments. When the socialists of Pasok came to power in 1981, they did not pursue any further nationalizations. Yet they had to manage the nationalized industries, being in the red, a process that led gradually to the closing of some and the privatization of the rest in the late 1990s.

Public expenditure started to increase in 1979 but it expanded drastically by Pasok during the 1980s. By 1989 the public expenditure had risen to 40 % of GDP and by 1995 it was close to 46 %, where it remained ever since. Most of the increase of public expenditure was directed to welfare. Education, health, social insurance, and pensions increased rapidly. In effect Greece was lacking a welfare state until the 1980. It was established during this decade.

Yet economic conditions in the 1980s were not favorable. The economy was in crisis, the inflation rate was high (20 to 25 %), the drachma was devalued every year, growth was sluggish and de-industrialization was becoming intense. It was the tourist industry that was booming, but this was less than enough to balance the macroeconomic problems. Agriculture was also gaining from the European subsidies, after the full membership in the Common Market in 1981. The income of farmers was improving, but the explosion of imports undermined much of the gains.

Thus the expansion of public expenditure was financed through loans. The Greek public debt was created during the 1980s. In 1980 public debt was less than 20 % of GDP and by 1993 it was 115 % of GDP, a level where it remained ever since with few fluctuations. On an annual level the budget deficit was around 10 % and was financed through loans.

The deficit implies that tax receipts did not increase with the same rate as public expenditure. The taxation system, inherited from the past, was obviously unable to raise such tax receipts. Yet no tax reform took place and indirect taxes remained the main source of taxation. The introduction of the value added tax, enforced by the European legislation, helped to rationalize the preexisting system of consumption taxes and stabilize it as the major source of tax receipt. Yet it was never used as an instrument to identify real incomes of business and private incomes and develop a proper system of income taxes.

Direct taxes continued to be paid only by the waged and salaried strata. In effect the very vast majority of the most affluent strata of the Greek society continued to pay not more than symbolic taxes. This included all kinds of business from banks to commercial and manufacturing firms, together with a wide range of professionals (lawyers, engineers, doctors, etc). Under the circumstances, with the 20 % of the wealthiest part of the population avoiding taxation, it led to an impossible situation. Taxation could raise something in the range of 30-35 % of GDP, while expenses reached the 40-45 % scale. Without a fiscal reform there was no way to balance the

budget. By 1993 the budget deficit was 14 % and in 1994 it had reached a new record at 15 % of GDP.

The new model of economic growth

By the mid-1990s the Greek economy was in a period of gradual adjustment and change. The Socialists were back in power (in 1993 the ageing Papandreou and in 1996 Simitis). The neoliberal dogma was the predominant theme of the Simitis government (1996-2004) and the entrance in the Euro zone was set as the first national target. Fiscal adjustment and monetary stabilization became the priority goals of economic policy. The Maastricht accord was used as a symbolic strategy for a new sound Greek economy. Privatizations, first of all of the banking system, the liberalization of the external capital market, and the explosion of the Athens Stock Exchange promised a new round of business investment and economic growth. The Olympic games of 2004 were to become the symbol of a renewed affluent society.

This stabilization process seemed at the time quite sound. Inflation was declining due to the policy of the »hard drachma«, the budget deficit was reduced and the rates of growth of GDP were relatively high, in any case higher than the average rate of the EU. There is little doubt that a second major transformation of the Greek economy was underway.

The neoliberal dogma favored the specialization of the Greek economy wherever there was some international comparative advantage. Tourism, shipping, construction, banking and telecommunications were the major sectors that attracted investment. The comparative advantage was obvious in the case of tourism and shipping. Tourism had an uninterrupted growth since 1975, when the numbers tourists were at 3 million per year, while by 2005 it had reached the 14 million. Shipping was favored by China's entrance in world economy and the booming of world trade. The rest of the sectors referred to the expansion of Greek companies to a new geographical space, that is the Balkans and Central and Eastern Europe. A wave of investments of Greek banks, telecommunications firms, commercial and manufacturing companies was already under way. In these areas Greek exports were also doing relatively well.

This new economic structure reminded of older patterns of the Greek economy which depended on a combination of various service sectors and some complementary manufacturing. Yet now it was renewed through a more international aspect. This new movement depended on two major strategic choices: the liberalization of the economy and the entrance to the Euro-area.

The Euro was central to this strategy as it made possible the free movement of capital in this broader geographical area. In addition it made possible the attraction of the Greek shipping capital back to Athens as well as it facilitated the incoming tourist receipts. In effect the Euro was a major step towards the more internationalized function of Greek capital. A weak drachma would have deterred the flow of foreign exchange back to Athens.

Yet this orientation of the economy had a negative impact on the productive sectors of the economy, agriculture and manufacturing. Agriculture entered a period of relative decline until 2000 and absolute decline thereafter. Manufacturing was already in a permanent pattern of relative decline.

The analysis of the external relations of the economy is indicative of the changes. Nowadays agricultural and industrial exports represent 10 % of GDP. Tourism adds another 10 % and income from shipping another 10 %. Imports nowadays have increased to 40 % of GDP, thus there is a permanent deficit in the balance of payments, which is usually financed through loans, subsidies and other minor sources.

This new orientation of the Greek economy was sustained by the massive inflow of migrants from Albania, the Balkans, Eastern Europe and the Arab world. About one million foreign workers provided much needed cheap workforce in construction, tourism, small-scale manufacturing and other services. At the same time it renewed part of the declining agriculture. Total employment increased from 3,3 to 4,2 millions within a decade.

As the new structure of the economy favored large scale firms, waged and salaried forms of employment prevailed. The Greek economy, which was traditionally identified with small-scale family business, was gradually transformed into a more typical European economy with 65 % of its employment being waged and salaried workforce.

As the family type of business was under stress, public employment was becoming attractive for the new generations that usually held a university degree. In the private sector the new waged strata were facing the new framework of low wages and flexible employment. Unemployment, as in other Mediterranean economies, remained high, around 10 %.

A major feature of this new transformation of the Greek economy towards an economy of services, is a peculiar combination of state expansion and privatization of the economy. As successive sectors were privatised this process added new expenses in the budget and the insurance system, which is run by the state. At the same time newly privatised sectors continued to depend on public finance, state regulation and of course state purchases. The interdependence of the private economy and the state reached new proportions, leading to a new phenomenon, that of political corruption.

The public sphere of the economy, which represented 45 % of the GNP, became the privileged space of political management, with possible corruption, manipulation and favoritism. The size of public administration did not expand, as many people think. It remained close to the OECD average. Yet public employment expanded rapidly in local authorities, education, health, various state organizations and agencies related to the management of European resources and development projects. The political system and primarily the two major parties gained immense economic power and ability to control resources. The idea that due to privatization and globalization there is a retreat of the power of the state, is totally misleading. The state had never in the past such power to control economic developments, negotiate huge contracts and manage resources. As a result during the last twenty years it is the theme of public corruption and scandals that dominate internal politics.

The fiscal crisis

Despite such drastic changes in the economy the balancing of the budget was never attained. The budget deficit was a permanent phenomenon. The Simitis government attempted to introduce some minor tax reforms, but made no major attempt to reform the system. Thus the reduction of the budget deficit did not lead to the decline of public debt, which remained at the usual level of around 110 % of GDP. Thus in 2000

and thereafter successive Greek governments started to manipulate macroeconomic fiscal indices and to negotiate with Brussels on the management of the public debt.

In effect since 1977 the Greek budget has been in deficit for 30 consecutive years. Running a deficit for so long is a paradox. Particularly during a period when successive stabilization programs have been implemented over and over again. The programs of 1985–87, 1990–93, 1996–2000, 2005–2007, and the current one, under the IMF, constitute a chain of successive stabilization programs, that all led to the decline of the budget deficit for a couple of years, by increasing at the same time overall public debt. Such a paradox may only be explained if the fiscal question is addressed through the real cause producing and reproducing the budget deficit.

Since 1995 this neoliberal era facilitated not only the abolition of any idea of tax reform, but strengthened even more the idea of »legal tax evasion«. A »fragmented system« was gradually build, which taxed specific social and economic groups with reduced income rates. This process included the strong business interests (banks, shipping, etc), but also various professional groups and all kinds of family business. Thus taxi drivers are taxed irrespective of their real income through a fixed low income. Engineers have a special rate of 15%. Lawyers are excluded altogether. Even public employees with high salaries have a special regime as bonuses are taxed with smaller rates.

On the other hand a complex system was build, so that income revealed through luxurious consumption could be avoided. Expensive cars, villas and yahts, were protected by a complex system of off-shore ownership and various other legal formulas so as to remain unidentifiable. In effect the taxation system in Greece adjusted so to safeguard that the richest 20% of the population was not going to pay income taxes.

At the heart of such arrangements lies the fact that no government either conservative or socialist was ready to tackle the problem. As these social strata represent the hegemonic groups within the party structures, this issue is usually not included in the political agenda. Because it constitutes a rather obvious issue, it is commonly referred to prior to the elections, yet forgotten thereafter.

As the problem of the budget deficit was reproduced, and the stabilization programs failed one after the other, public expenditure was permanently under pressure. The welfare state was demanding more and more resources. Similar to the taxation system, here again the system was »fragmented«, with special arrangements covering specific categories and subcategories of employees and professionals. While the system was even from the late 1990s non-viable, the governments continued to use the welfare system for political manipulation and political control of various social groups.

As social inequalities increased, the welfare system became a space of increasing social pressures. Prior to the economic crisis, the social insurance system and the health system were demanding additional resources. Such resources were obviously not available, unless the state reduced military expenses, contained public corruption and improved the management of public resources.

When the economic crisis of 2008 started to produce its worldwide impact, the Greek economy was already in a process of disintegration. The conservative government that was in office since 2004 absorbed the pressures by increasing public expenditure (probably at 50% of GDP), while it attempted to sustain growth through reduced taxation of business and wealth, the latter reducing tax receipts even below the usual 35% of GDP.

The manipulation of fiscal data became, probably with or without the knowledge of Brussels, part of a strategy leading to a dead end. The crisis was now imminent. The new socialist government, chose the new EU-IMF package, which as previous »stabilization packages«, is expected to increase social inequalities, reduce the budget deficits, but sustain the public debt at its current size. The IMF package does not address the social nature of the fiscal problems in Greece. It aims at curing the budget deficit through the reduction of wages and welfare expenses and the generation of disinflation and a recession.

The question of fiscal stabilization is the direct result of an established system of social inequalities in Greece produced and reproduced through the taxation system and the fiscal arrangements of the Greek state. Budget deficits are part of a process generating and sustaining, in indirect ways, incomes and profits. Drastic social and economic reforms in both taxation and public administration may lead to a more just and viable solution to the fiscal question.

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