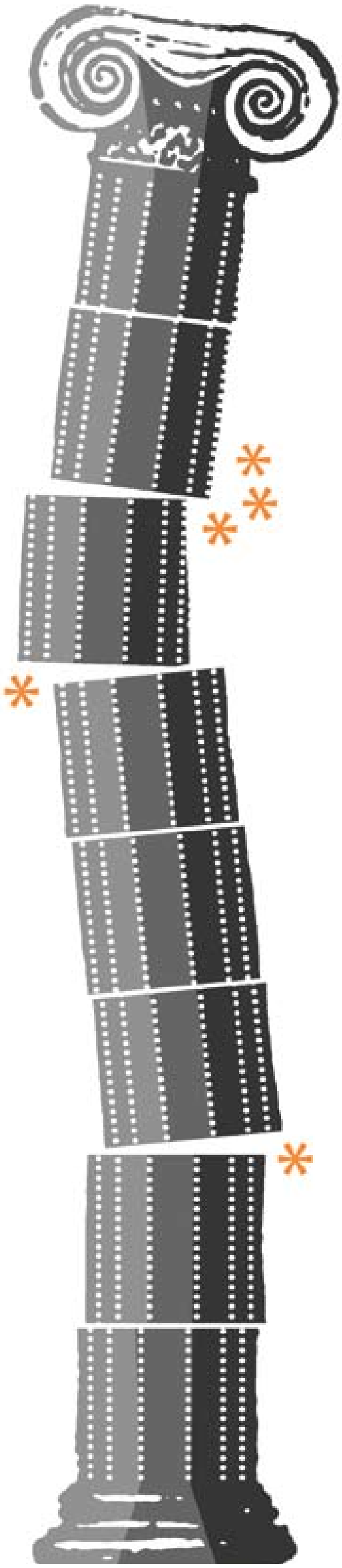
BEYOND
THE CRISIS

THE REAL PROBLEM WITH GREECE



What really lies behind the economic fall of Greece? ***Michael G Jacobides*** *provides administrative lessons from a fiscal tragedy.*

As the debt crisis in Europe unravels, we are starting to build a better understanding of what really caused the crisis and how it should be resolved. Only a short while ago, analysts were focusing on the similarities between Portugal, Ireland, Italy, Greece and Spain — lumped under the unflattering "PIIGS" acronym. Yet as events unfolded, it became clear that each country had a very different set of problems. Nowhere has this been more evident than Greece. As the crisis in Greece took a turn for the worse, European leaders of other struggling economies, as well as senior civil servants and Eurocrats, took pains to explain how Greece was a "particular case".

Yet, while there is a growing consensus that the Greek problem may be idiosyncratic, it has, by and large, been treated as an "ordinary" case of macro-economic imbalance. Expenditures vastly exceeding fiscal receipts and an inefficient public administration are rightly seen as the kernel of the problem, and Greece has been pushed to restore fiscal balance.

But, there is much more to the Greek crisis than this. The true underlying issues are a crumbling public administration and a political system where a few beneficiaries distort economic flows in the country, stifling development and depleting state resources.

While such structural problems have been noted for a while, their magnitude seems to have been underestimated. The true Greek tragedy is that a country that could potentially be on a solid growth trajectory is instead facing chaos because of the way the public sector (and its associated political system) interferes with the use of public resources. The press has been part and parcel of this corrupt system, impeding the understanding that would help resolve the issue.

More consequentially, it has proved convenient for the stakeholders in the crisis — in particular the European Union — to avoid confronting the real nature of the problem. Doing so would require the sort of far-sighted action and pragmatic leadership that is — perhaps understandably — lacking from politicians concerned with re-election and administrative units vying for relative power.

As a result, kicking the can down the road has become the de facto solution, in the hope that things get better. The EU and the IMF have been treating a cancer with patches and aspirin. They have been busy addressing the symptoms of the sickness, without daring to address the underlying cause. But it's time we addressed the problem head-on, whatever we think about its appropriate resolution.

The state of the problem

The problem in Greece is three-fold. First, the public sector has proven to be a woeful manager of its own resources. The Greek public administration lacks accountability as well as a stable backbone of senior civil servants. It relies on formalistic rules to guide every step of the operation of public administration, as opposed to focusing on how it can substantively serve its purpose. These personnel issues, along with poor information and management systems (or data of any sort), mean that the public output related to expenditure is disappointing.

Serious problems exist at the top of the structure. The political system is highly influential and self-serving; its beneficiaries are able to carve out excessively compensated positions within the broad public sector, which means diverting funds from where the need exists. One such need, not surprisingly, is the growing number of Greeks living below the poverty line, as well as increasing criminality. Finally, an extremely important problem in Greece is tax avoidance — Greece has only 29 per cent of its GDP as tax receipts; the EU average is 37 per cent. The inability to tax fairly has hit not only public finances, but has also created a sense of unease and social discomfort with taxation, especially under conditions of duress.

Second, the interface between the private and the public sector has seriously skewed the productive tissue in Greece. The Greek state has been a purchaser of services for construction, armaments, technology and more mundane goods and services. Side-payments are often inherent to such procurement. So, exposed to a corrupt system, many Greeks have shown initiative, adaptability and drive but, sadly, this has further increased the incidence of corruption. Entrepreneurial drive and corruption have created a vicious circle amplified by the political system, but one which is not desired by most Greeks.

Third, the state distorts the functioning of the private sector. "Closed" or regulated professions that have given birth to local monopolies; a loose competition policy that does not really promote competition; and most importantly, a bewildering set of regulations, all deter entrepreneurial activity and private investment. Capricious taxation and unpredictable authorities add to the problem of a malfunctioning justice system, with long delays and inefficient procedures. All of this means that reduced Greek labour costs have yet to translate into reduced prices and productive investment has all but stopped.

A Greek hangover

With these problems in the background, the genesis of the Greek debt crisis comes into sharper focus. After a period of fiscal and economic adjustment which led to Greece joining the euro, loosening happened from the beginning of the last decade. Ratings agencies were unsurprisingly short on due diligence and overly soft on Greece and thus Greece enjoyed a prolonged period of low interest rates. The availability of cheap credit in a time of plenty meant that the structural reforms that had helped Greece join the euro, politically difficult as they were, had no reason to continue. Political parties then focused their tactics on blaming their opponents, and damaging Greece along the way.

Of course, after every party, there's a hangover. Yet Greece's party was not one of a uniform wealth creation. It was a party of targeted, limited wealth creation and substantial redistribution, made alongside increased rigidities in the Economy. Problematic structures became worse and the dependence on borrowing increased ever more. Then, in 2009, the party was over. Yet neither in Greece, nor in the EU, was the problem appropriately diagnosed. Greek officials initially ignored the problem, and then denied its magnitude. European officials wished it away. Decisions were taken with the horizon of a few months. Greece did have the option of facing the problems, addressing inefficiencies and restructuring its debt. Yet, weak leadership simply kicked the can down the road. Worse, rather than restructuring its debt, it substituted its private debt with official debt (coming from the EU and the IMF), tying its own hands in the medium term.

When in 2012 Greece eventually restructured its debt, its private debt was just over half of the total. So a 53.5 per cent haircut translated to a 30.5 per cent reduction of its total debt exposure, as the EU and IMF debt could not be restructured. In other words, Greece and the EU/IMF allowed the private creditors of Greece (primarily large French and German banks — as well as some Greek ones) to be fully paid at the expense of European and other

IN SEARCH OF CAUSES AND SOLUTIONS

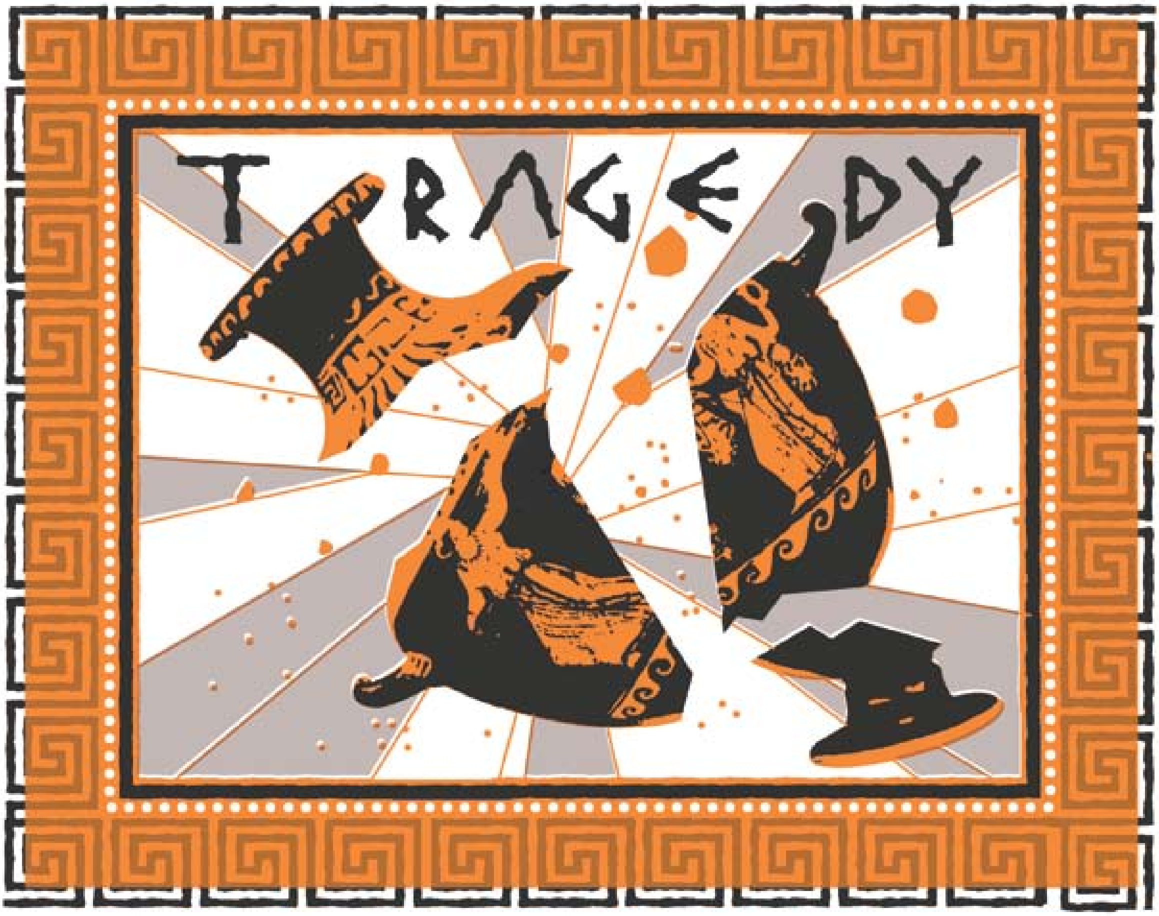
In an effort to reform the Greek administration, in October 2011 London Business School's Richard Portes and Michael G Jacobides, and Dimitris Vayanos of the London School of Economics, convened a meeting in London where former Greek ministers, current MPs, senior bankers, industrialists, policy-makers, central bankers, academics and turnaround specialists from Greece and internationally, came together to discuss the way forward. The resulting White Paper proposed a transformation programme of the Greek public administration. This involves independent authorities with a clear responsibility and mandate, working toward focused key performance indicators — such as a Tax Assessment and Collection Authority, a Reforms Authority, a Healthcare Authority and a corruption initiative.

The group considered how tax evasion should be tackled head on, and why the focus should be on the rationalisation of public authority design. It also considered why privatisation should be seen as a tool to improve resource allocation and management rather than a mere source of cash, and how debt financing could be combined with sales of assets and state-owned firms to help achieve the goal of restructuring Greece.

To tackle the Greek problem, the underlying causes, as opposed to the symptoms alone, need to be treated. And to do so, awareness and involvement is needed, in Greece and internationally.

With this in mind, in January 2012, the Hellenic Alumni Club and the Hellenic Student Club of London Business School put together an invitation-only event on Greece: Options Ahead. This addressed the main aspects of the Greek crisis — the debt problem, the reform of public administration and the changes needed to support growth.

The website, www.redesigngreece.org aims to help not only educate, but also create a forum to help inform the debate and shape the change process in Greece.



taxpayers, while leaving the underlying causes of its malaise entirely intact.

More important, though, were the responses from Greece's creditors. Due to the fact that the European Union, the IMF and the ECB were providing liquidity to Greece, the power has gradually shifted from Greece's decision makers and politicians to those controlling the purse. Creditors, of course, do understand that structural changes are needed. And they have promoted market-friendly changes, particularly the liberalisation of closed professions and the modernisation of the administration. Yet structural measures have not been their real focus. Worse still, many of the measures taken, and even more of the measures discussed, seem to be oblivious to these hard realities that cause the deficit.

Take, for instance, the behaviour of the EU and Greece's creditors to date. The focus has been on fiscal targets, with flexibility on "structural changes". Some of the most painful measures imposed by creditors, such as the lowering of the base-wage, have never featured high on the employers' agendas, while structural issues — such as cutting red tape or combating rampant corruption — have taken the back seat. And even where organisational structures were considered, little attention was paid to implementation. While there has been a decision to merge and cut the funding to many organisations in the broader public sector, little, if any, provision has been made on how these restructured problematic institutions will rationalise and restructure their operations. The basic administrative issue of the time, resources, skills and attention required when merging and redesigning organisations has not received any sustained attention.

Exit strategies

Alternatively, consider the ongoing debate on Greece's potential exit from the euro. Regardless of the ramifications this would have for Europe and the euro, such an exit would do nothing to address the underlying weaknesses. Sure enough, Greece would be able to devalue, and inflation would ensue. The root causes of the problem, however, would remain intact, if not worsen. Banks taken over by the state, as a result of the exit from the euro, would likely cause the allocation of credit to suffer as politicians would use banks, and the allocation of credit, as their source of power and influence in a declining economy. Private firms with euro-denominated debt might need to be declared bankrupt. Given the structural inefficiencies, little could come in the way of new entrepreneurial entry that would help regenerate the economy. With the crisis introduced by a forced currency change, a solid public administration would be needed to helm Greece through the transition and, as previously detailed, there is hardly one functioning under current fairer weather conditions.

Structural issues are at the core of the problem and unless they are tackled, leaving the euro would be more of a hindrance than a solution.

Essentially, Greece's problem is administrative. It is a problem of the design of the government and its institutions, which prevents a highly skilled, well-trained, entrepreneurial workforce working more hours than the EU average (against the stereotypes enshrined in the press) from realising its potential. And the challenge is that even today, as Greece's creditors are starting to focus more on structural problems (albeit two years too late), the need is urgent and needs to be combined with a focus on implementation.

The upside

There is, of course, some good news. The EU has set up a taskforce to help Greece's transformation. Particular areas are being developed by national teams — for example, a French team is helping rethink the administration and a German team has come to improve taxation. Their value will lie not only in the transfer of knowledge, but more importantly in their independence and ability as separate bodies to consider existing and proposed changes. Announcements have been made that the reform process will be monitored, although the way this will be implemented remains unclear. Greece's challenge is an organisational one and this will determine its macro-economic survival. The magnitude of the task is great and public understanding — in Greece and abroad — is still limited. The proof will be in the reform pudding.

Rather than considering "how much" state is good, the real question is "how efficient" the state is. Rather than fretting about regulation, we need to consider the accountability and transparency of those who regulate instead. Rather than looking at macro-economic, aggregate indicators — which reflect real economic activity with a lag — we should consider progress on the treacherous path to structural and administrative reform. Rather than creating a EU Taskforce comprised of senior public servants from the EU, we urgently need experts in administrative reform and change management. Rather than focusing on austerity measures, we need to focus on restructuring the administration. Whatever happens with politics, elections, the EU, or adjustment of the current loan programme, the umbrella task should be a redesign effort, focused on solving the organisational and administrative problems. These are the root causes and these should — and must — be the focus of attention.

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Evidence through history shows that large-scale transformation is possible. Consider Denmark — often held as an exemplar of public administration and effective welfare state: prior to the 1840s it was the paragon of corruption and state inefficiency, yet managed to change in little over a decade. Or consider all we know from organisational behaviour and change: changing the system, structures and culture can transform organisations and institutions. From IBM to American Express to Saatchi & Saatchi, to the transformation of the former Soviet Bloc, there is evidence aplenty that changing structures, incentives, accountability and processes is what allows individuals to change their ways. Greece has a healthy private sector and a well-educated workforce, which is currently beholden to an inert and ineffective system. So the upside could be great, even though the threat of uncontrolled bankruptcy is ongoing.

While the road ahead for Greece may be uncertain, what is certain is that it can teach us the perils of confusing a symptom for a cause, of ignoring the administrative basis of macro-economic output. □

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