As the eurozone’s weakest economy struggles to bring sovereign debt under control, can Greece’s new government turn the economy around, and is the country able to accept the pain of transformation into a modern state?

At the heart of the Greek debt crisis are outmoded attitudes towards the state as a duty bearer, and the role of citizens as rights holders that do not sit well with the needs of a modern state functioning in a globally-linked economic and financial system.

The stakes are too high for failure, but do Greeks really have sufficient appetite for real change? Can rampant Greek individualism ever be harnessed to come together to think as a collective entity? Will Europe be patient enough to wait and see if Greece is capable of complying with its deep structural reform commitments, or would it increase the pressure and eventually push the country out of the euro?

The Roots of the Crisis

The Greek debt crisis is rooted in three internal issues: (i) policies towards public employees, and protectionism; (ii) the Byzantine complexities of certain aspects of its economy; and (iii) an almost pathological individualism of the Greek national character which leads many people to have a “default setting” of rebelling against the prevailing “system” – whatever that constitutes, and whatever the outcomes and the impact on individuals and on society as a whole. However there is a fourth, external factor: the rapacious appetite for debt of the European and US banks, which do not escape entirely blameless, either.

(i) The Public Sector

The expansion in the numbers of civil service employees during Greece’s conservative governments of 2004-2009 stretched the limits of what was already an inefficient state: reportedly an additional 75,000 new posts were created during this time. To sustain the financial costs of this increase, governments had banked on its ability to sustain a growth rate of 3% per annum. As the world by now knows, this failed miserably, and as a result, borrowing costs soared. The situation was compounded by at best inaccurate and at worst actually false data being provided about the deficit. The current socialist Prime Minister George Papandreou who came into power in October 2009, has been left to deal with the resulting mess, whilst his predecessors got off lightly.

(ii) The Informal Economy

To give an idea of the extent of the informal economy in Greece, “black” money is estimated at 30% of GDP, and its tentacles reach into all sections of society and the economy. For instance, Greece, like other European states, has functioning public schools, but the poor quality of education means that to succeed in their examinations, students need to have tuition out of school – provided by the same teachers, for a fee undeclared to the tax authorities. The parallel with similar situations in developing countries (for example, Paki-
To survive the debt crisis, and to turn itself into a modern, globally-competitive state, Greece needs to reinvent itself.

The crux of the matter is therefore that Greece now stands at a crossroads, and faces having to make the tough choice between accepting and implementing heavy structural reforms - including very difficult socio-cultural changes - or being pushed into the periphery of the single currency. Opting out (or being thrown out) of the single currency is simply not a realistic possibility, because the “united states of Europe” – sacked in the 14th century by a band of Catalan mercenaries who were upset by the Byzantine emperor - which brought down the last conservative government, through its involvement in a land scam. (It also netted the monks a mere $240,000 in compensation for the Catalan episode, seven centuries later, which they cannily managed to extract from Spanish government officials, as a result of interest taken in the monastery by a visiting Spanish singer). Lewis uses the activities of the monks on the isolated, male-only Holy Mountain (which disallows even female animals, other than for cats required to keep down the rat and mouse population), as a barometer for the Greek debt crisis.

But, beyond the total of $1.2 trillion debt (roughly a quarter-million dollars for each working adult), there is a more frightening human deficit. After systematically looting their own treasury, in what Lewis terms “a breathtaking binge of tax evasion, bribery, and creative accounting spurred on by Goldman Sachs”, he sadly concludes that Greeks are sure of just one thing: they can’t trust their fellow Greeks.

Greek attitudes towards taxation are encapsulated in the following vignette by Lewis, in a conversation with a prominent Greek tax collector. The conventional wisdom has it that the only Greeks who paid their taxes were the ones who could not avoid doing so—the salaried employees of corporations, who had their taxes withheld from their paychecks. The vast economy of self-employed workers - from doctors to kioski vendors, who had their taxes withheld from their paychecks. The vast economy of self-employed workers - from doctors to kioski vendors – importantly – goes undeclared and untaxed. The same applies on an-the-ground reality that weak members simply have to be assisted to “swim”, rather along the lines of the US federal-state relationship, rather than letting them “sink”.

(iii) Byzantine Practices

In an article which links the essence of the Greek debt crisis to a remote monastery on the secluded Mount Athos, Michael Lewis traces the almost surreal story of the Vatopaidi monastery – sacked in the 14th century by a band of Catalan mercenaries who were upset by the Byzantine emperor - which brought down the last conservative government, through its involvement in a land scam. (It also netted the monks a mere $240,000 in compensation for the Catalan episode, seven centuries later, which they cannily managed to extract from Spanish government officials, as a result of interest taken in the monastery by a visiting Spanish singer). Lewis uses the activities of the monks on the isolated, male-only Holy Mountain (which disallows even female animals, other than for cats required to keep down the rat and mouse population), as a barometer for the Greek debt crisis.

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Not So Much a Taxation Issue….More a Way of Life?

For most of the 1980s and 1990s, Greek interest rates had run a full 10% higher than German ones, as Greeks were regarded as far less likely to repay a loan. At that time, there was no consumer credit in Greece: Greeks did not have credit cards, and they did not usually have mortgage loans either.

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1. Financial Times Sept 15, 2010

enforcement. The easiest route to laundering the ubiquitous “black” money that everyone comes across in Greece - (for example, how many restaurants on even up market Greek islands accept credit cards?) is to buy real estate, pay in cash, and fail to provide a receipt, or take one for a lower figure, depending on your appetite for risk. Conveniently, Greece has no functional land registry, which makes (legal) clear title property owning into a minefield.

The systematic lying about income had led the Greek government to rely increasingly on taxes that were harder to evade: real estate and sales taxes. Real estate is taxed by formula, which generates a so-called “objective value” for each home. However, the boom in the Greek economy over the last decade caused the actual prices at which property changed hands to far outstrip the computer-driven appraisals. Given higher actual sales prices, the formula is meant to ratchet upward. The typical Greek citizen responded to the problem by not reporting the price at which the sale took place, but instead reporting a fake price, which usually happened to be the same low number at which the dated formula had appraised it. If the buyer took out a loan to buy the house, he took out a loan for the objective value and paid the difference in cash, or with an informal-market loan. As a result the “objective values” grotesquely understate the actual land values. An indication of just how prevalent this is, is shown in the widely believed anecdote that all 300 members of the Greek Parliament declare the real value of their houses to be the computer-generated objective value. Or, as both the tax collector and a local real-estate agent put it to Lewis, “every single member of the Greek Parliament is lying to evade taxes.” The structure of the Greek economy is collectivist, but the country, in spirit, is the opposite of a collective. Its real structure is every man for himself. Into this system investors had poured hundreds of billions of dollars. The credit boom then pushed the country over the edge, into collapse.

Statistical inaccuracy or outright obfuscation has long been a fact in Greece – something acknowledged even by Eurostat, the EU’s statistical arm. Indeed, it probably contributed to Greece’s acceptance into the EU. (Even as late as last year, Greece upped its fiscal deficit to 13.6% of GDP from the previously stated 12.9%. In 2000, after a flurry of statistical manipulation, to lower the budget deficit the Greek government moved all sorts of expenses (pensions, defense expenditures) off the books. To lower Greek inflation the government did things like freeze prices for electricity and water and other government-supplied goods, and cut taxes on gas, alcohol, and tobacco. Greek-government statisticians did things like remove (high-priced) tomatoes from the consumer price index on the day inflation was measured.

All sorts of rumours about the crisis continue to circulate, including the one about Prime Minister Papandreou having to deny he was about to sell any islands; and the other one about China buying up Greece’s entire sovereign debt (surely the all-time great commercial opportunity to complement the purchase of Africa’s natural resources?). But what really is the domestic impact of the crisis? Other than as measured in strikes (the transport workers) and the general surfiness of the government employees staffing the Athens metro (not a good way to woo the tourists), the domestic impact of the crisis is hard to gauge in factual terms.

The move by National Bank of Greece to strengthen its capital base by borrowing €450m through subordinated bank debt is seen as a positive sign by analysts and investors. On the other hand, strikes still persist, though currently with less violence: the ubiquitous newspaper “kioskis” struck on September 9 and 10, to protest the damage done to their business by the rise in the special consumption tax on cigarettes. Earlier, in late July, Greek police fired tear gas to break up a demonstration at the transport ministry by hundreds of striking truck drivers who had rejected an emergency civil mobilisation order, though in the same month, George Paapostantinou, the finance minister, says Athens has taken more measures than necessary to cut its deficit this year from 13.6% to 8.1% of GDP but the government still faces strong resistance to structural reforms.

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Furthermore, the government’s overturn of long-standing retirement benefit provisions for working people in the spring of 2010 will have powerful ramifications for generations to come.

The new legislation includes a packet of reforms that will essentially overturn the current system of retirement benefits. The new increases in retirement age will affect hundreds of thousands of workers. Until now, those who have completed 35 years of work had the right to full retirement at age 58. They will now have to reach 60 before becoming eligible for full pension. For women, the retirement age is increased from 57 to 60. In both cases, an additional six-month period is mandated for each working year after 2013. For those who work in hazardous occupations, the retirement age is extended from 55 to 57 for full retirement and from 53 to 55 for partial.

The new “anti-social security” measures will hit working mothers especially hard, increase retirement age by two to five years, and reduce pensions by 10% to 40% for future retirees. Working mothers with dependent children face the most dramatic cuts. Opportunities for earlier retirement with partial pension for mothers below the age of 50 with dependent children are being eliminated. Earlier retirement will now be possible only at the age of 55. For self-employed women the age of retirement is going up from 50 to 55. Special provisions for women with three or more children are being eliminated.
Not surprisingly, Greek trade union and community forces have been mobilizing for many months in an all-out effort to thwart legislation, which was mandated by the European Union, being pushed through. Both the conservative party and the socialist PASOK have been laying the groundwork to dismantle the country’s social security system for the past 20 years during their respective terms in office. Labour and progressive groups charge that the two parties are responsible for the state’s “robbing” of the pension fund and its predicted bankruptcy in the next 20 years.

The Real Problem

A critical issue Greece has to deal with is confidence. If bond investors start to lose confidence in a country’s eventual willingness to run even the small primary surpluses needed to service a large debt, they will demand higher rates, which requires much larger primary surpluses, and a so-called “death spiral” can ensue.

Whilst undoubtedly the unaffordable costs of the welfare state issue is a major concern, at the heart of the crisis lies the lack of regulation of financial capital – exactly the same factor that triggered the Wall Street collapse.

In the case of Greece, first, the country piled up an unsustainable debt load to build a welfare state that it could not afford. Second, it has seen a rampant flight of capital since word of the crisis first got out. But, third, it has also seen huge inflows of illegal capital as well, which have not been reflected in national accounting.

One beneficiary of Greece’s flight of capital is London, which has been profiting from the country’s financial turmoil. In April 2010, Greek buyers accounted for about 6% of all property purchases above 2 million pounds (£2.3 million) in the U.K. capital – double the average of the past three years, according to real estate agents Knight Frank. Greek island homes, long coveted by millionaires and Hollywood stars, were reportedly being marked down by as much as 45% at the start of the summer; across Greece property sales are stagnant; and it is unlikely that things will improve until the economic picture becomes clearer. Many would-be buyers are waiting to see the outcome of the government’s plans to increase the so-called objective value it places on real estate for tax purposes next year. The system depends on an assessment of a property’s value based on the area and amenities, rather than on the actual market value, which is usually higher. Papandreou’s austerity package calls for an extra levy on properties valued at more than 5 million euros – in part to convince voters that the wealthy are also helping to foot the bill. Owners of homes worth more than 400,000 euros also will pay higher taxes and the program thus puts pressure on homeowners and debt-laden developers to lower prices.

Europe & the US: Have They made it Worse?

It has been estimated that, in their drive to raise more and more profits from lending, Europe’s banks poured $2.3 trillion into what are now the most troubled European economies: Ireland, Greece, Belgium, Portugal and Spain. German and French banks hold some 70% of Greece’s $400-billion debt. German banks were great buyers of toxic subprime assets from US financial institutions, and they applied the same lack of discrimination to buying Greek government bonds. For their part, since the outbreak of the financial crisis, French banks, according to Bank of International Settlements increased their lending to Greece by 23%, to Spain by 11%, and to Portugal by 26%.

The frenzied Greek credit scene featured not only European financial actors. Wall Street’s Goldman Sachs showed Greek financial authorities how financial instruments known as derivatives could be used to make large portions of Greek debt “disappear,” thus making the national accounts look good to bankers that were always eager to lend more. Then the very same agency turned around and, engaging in derivatives trading known as “credit-default swaps,” bet on the possibility that Greece would default, raising the country’s cost of borrowing from the banks but making a tidy profit for itself.

Whilst undoubtedly the unaffordable costs of the welfare state issue is a major concern, at the heart of the crisis lies the lack of regulation of financial capital – exactly the same factor that triggered the Wall Street collapse. A frenzied drive by finance capital to draw profits based on the indiscriminate, massive extension of credit had a large part to play.

If ever there was a crisis created by global finance, it is Greece. However, the country’s own labyrinthine Byzantine practices do not help with the solution.

The Solutions & the Challenge

How Greece performs will not only affect Greeks, but the value of the euro and the whole 27-nation European Union. In that sense, we stand and fall together.

Prime Minister Papandreou is clearly the man of the hour, and he is also serious. Hosting his own “mini-Davos” annually on a different Greek island, Papandreou calls regularly

4. Derek Gagopouloous. This is a pattern traced by Carmen Reinhart and Kenneth Rogoff in their book This Time is Different: Eight Centuries of Financial Folly (Princeton: Princeton University Press, 2009). Periods of frenzied speculative lending are inexorably followed by government or sovereign-debt defaults or near defaults. In this view, like the third world debt crisis in the early eighties and the Asian financial crisis in the late nineties, the so-called sovereign-debt problem of the southern European countries is principally a supply-driven crisis, not a demand-driven one.
Papandreou says he is ready to face whatever has to come and so, too, he insists, is his country: “People are saying to me, ‘change this country — go ahead and change it.’ People realize that it needs change. You don’t want to miss this opportunity. . . . We’re going to bring in best practices from Europe and around the world to reform this country . . . . It is difficult, and there will be protests, and people will feel bitter, but it will be one of the most creative times Greece has gone through.”

So, can Greece have a peaceful civic revolution? The odds are long, but the yardstick may be Greece’s youth, rather than the pronouncements of the IMF. If in six months time, they are migrating, in brokerage terms, “short” Greece. If they stick it out, it means there is something there that is worth staying for — and buying Greek bonds might not be such a bad idea.

With tourism contributing between 15-16% of GDP, the transport strikes that hit hard in summer 2010 caused nationwide fuel shortages. Shooting itself in the foot again, the outgrowth of the crippling strikes was that the tourist industry — critical to Greece’s economic survival — has been in despair and countless holiday cancellations were triggered. Many European tourists cancelled holidays, resulting in massive reported drops in tourist levels that persisted into August – the prime holiday month. Medical supplies, food and fuel ran dangerously low. Greeks and foreigners remained stranded on the islands; abandoned cars that had run out of petrol were left by the roadside, and Greece’s image took a severe denting. Prime Minister George Papandreou ordered truckers to return to work on July 28, given the “serious upheaval” to Greece’s social and economic life in the middle of the key summer tourism season. About 33,000 truckers, including tanker owners, were protesting government plans to open up the freight industry and issue new licenses. The government backs the plans because they will boost growth potential, not because they are part of the terms in the loan package, he insists. For some observers, the strike constituted the most serious challenge so far to the government during the financial crisis.

The irony of the situation is that the harsh adjustment is being presided over by a Socialist government headed by George Papandreou that was voted to office to reverse the corruption of the previous conservative administration and the ill effects of its economic policies. There is resistance within Papandreou’s party PASOK to the EU-IMF plan, admits the party’s international secretary Paulina Lampsa, but the overwhelming sense among the party’s parliamentary contingent is, as Margaret Thatcher famously put it, “TINA - that ‘there is no alternative.’ ”

Restructuring: Will the Surgery Succeed?

Whilst many Greeks are genuinely in favour of the recovery programme outlined by the IMF and the EU – both because they see no other way out for Greece to avoid bankruptcy, and because it may in fact complete what the 2004 Olympics began, in terms of the modernisation of the Greek state and contributing to national pride. From this perspective, the restructuring provides the opportunity to rebuild both the economy, and the state itself.

It is clear however that this will be a difficult and risky task. As Alexis Papachelas put it: “Cleaning up corruption and tax evasion in such a short time is like undergoing...”

6. Interestingly, in a possible contribution to Greece’s dire need for external funds, in late September, Qatar’s sovereign wealth fund signed its second memorandum this year, for a preliminary deal with Greece for investments of up to 55 billion in the areas of tourism, real estate, transport, infrastructure, finance and energy. The May 2010 memorandum covered gas exports and storage facilities. Matthew Saltmarsh, International Herald Tribune September 25, 2010

7. Malcolm Brabant for the BBC, July 30 2010
major bypass surgery”. Will the economy still have a pulse? Perhaps it is not these gigantic demons themselves, but rather the enemy of recession, that will prove hardest to address. In this regard, the vicious cycle of recession hits even the healthiest businesses, because they have difficulty borrowing from banks which are being hit by additional taxes, whilst waiting to collect what the state still owes them. What percentage of these healthy businesses will be forced to close down or move to another country? To what extent is this likely to provoke social backlash? Should a wave of populism recur (notwithstanding the deaths in Athens during the riots in early summer), attempts at reconstruction could fail, despite the support of the IMF and the EU. Fortunately for Greece, its prime minister Mr. Papandreou and his open, friendly finance minister, George Papaconstantinou, seem to understand how domestic and international markets work – as well as the real needs of the economy. Notwithstanding, the ruling PASOK socialist party’s stance in local elections scheduled for November 2010 may prove to be an interesting barometer of populism.

Perhaps therefore a more frivolous – but possibly more accurate - yardstick for the success of the debt crisis alleviation measures can be found in the success or otherwise of the EU-imposed ban on smoking in public places: the last time it was imposed, it failed miserably. The blanket ban on smoking in public places, aimed at bringing Greece’s legislation into line with EU laws, took effect on September 1. It will apply to cafes, bars, and restaurants, as well as to offices and all public transport. Concerns remain about its implementation. Will the Greeks’ inclination to anarchy be toned down to bite this particular bullet, or will their natural independence of spirit and refusal to bow to authority, take priority?

All this brings us back to the Byzantine complexities of the 1000-year-old “corporation” – the Vatopaidi monastery and its monks who are almost surreally-well informed about the modern world, including its markets, on remote Mount Athos...

In a society that has endured something approaching the total moral collapse of its public sector credibility, its monks and their land scam have somehow become the single universally acceptable target of moral outrage. Every right-thinking Greek citizen is still furious with them and those who helped them, and yet no one knows exactly what they did, or why.10

So, will individualism prevail over collectivism, and will Greece do the unthinkable, and default? Probably not. But even if it is possible for the debt to be repaid, for people to live within their means, do Greeks have the inner resources to do it? Can they really behave as a collective? Maybe the real problem goes back to the monks – and their well-entrenched instinct for self-preservation, and what could be termed “individualistic collectivism”.

Time, out-migration, and the observance of the cigarette ban will tell.

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10. This extraordinary story is told in detail in the Lewis article. Among the first acts of the new Parliament was to open a second investigation of the Vatopaidi affair, to finally nail down exactly how the monks got their “sweet” land deal. The one public official who has borne the brunt of the offensive (who had his passport taken away, and remains free only because he posted a bail of 400,000 euros) is an assistant to the former (conservative) prime minister, Giannis Angelou, who stands accused of helping the monks.