SWP Comments

Stiftung
Wissenschaft und
Politik

German Institute
for International and
Security Affairs

SWP
1962–2012

A New Approach in and for Greece

After the Recent Greek Elections, Effort Should Focus on Modernising Selected Economic Zones and Empowering local Entities

Daniela Schwarzer

The recent Greek elections and a possible softening of the conditionality imposed on the country in exchange for the rescue package may give the recession-stricken country some breathing space. But the task is still immense: further cuts, liberalisation and far-reaching public sector reforms are pending, and the Greek economy, in recession for the fifth consecutive year, needs growth stimuli. Persistent discussion about Greece leaving the Euro area has slowed the inflow of necessary capital. Meanwhile, the top-down approach to reform is bumping against limitations. To enable administrative bodies to function, to break up fossilised structures and combat corruption and political cronyism, far-reaching reform is necessary. This can only be implemented by domestic forces, but will nevertheless profit from external support. A new strategy is required to avoid the feeling from prevailing across society that future prospects are lacking. This should be developed within the country with external support and, above all, focus on one thing: strengthening innovation at local and regional levels.

2012 is a decisive year for Greece. After a lengthy struggle, debt reduction of approx. 100 thousand million euros was achieved in March. The admission that there is a solvency problem was overdue. The most important political event was the parliamentary elections that took place on June 17. These second Parliamentary elections within two months were seen as a referendum on Greece's membership of the European Monetary Union and its adherence to the reform programme that the previous Greek government had accepted in exchange for liquidity support from the troika. Of crucial importance is, on the one hand, whether the new Nea Dimokratia-led government can implement the reform programme while negotiating a slightly more subtle approach to reforms and austerity with the troika. On the other hand, it has to cope with a strong Syriza-led populist opposition and has to contain the growing social and political tensions in the country which risk thwarting necessary change.

In the meantime, economic structures are changing, although still tentatively and on a small scale in many places. In the Lisbon Council's and Berenberg Bank's *Euro Plus Monitor*, which measures the reform dynamic of the economies in the Euro area,

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Greece receives a strong report. Of the 17 states, Greece occupies second place after Estonia, but does however have the worst starting point, still at some distance from Portugal and Cyprus. Greece does however receive the best marks for fiscal reform. In reducing unit labour costs and its external balance, Greece lies in fifth place in the Euro area. Although there is still a long way to go here, the good news is that the correction of the external deficit is not merely attributable to the slump in imports as a consequence of collapsed domestic demand. Over the course of 2010, the number of new industrial orders once more rose to pre-crisis levels. But even today, exports only contribute about 11 percent to Greek gross domestic product (GDP).

An increase in competitiveness is all the more important as setbacks are to be expected. In the tourism sector, which contributes a good 15 percent to the Greek economy, a drop of approximately a third is expected in 2012. Domestic consumption continues to weaken, which is hardly surprising given the trend in household income since 2009. In the public sector and in government enterprises, salaries sank by 30 percent. Pensions were cut by 14 percent in the public and private sectors. Unemployment rose rapidly to 21 percent. The monthly minimum wage was reduced by 22 percent, for those under 25 years of age it was even reduced by 25 percent. In contrast, VAT was increased – according to respective product group – by two to ten percent and now has a standard rate of 23 percent instead of 19.

Putting an end to Grexit-discussions

Current helplessness in the face of political and administrative challenges, the lack of prospects for growth and the fear of a vocal and strengthened radical opposition, as well as social unrest, are stoking discussion on Greece's potential exit from the Euro area – as a supposedly simple solution. But the effects of contagion would be difficult to control, potentially causing a serious crisis in the Euro area via the bond markets and the withdrawal of savings in other member states – a crisis the Euro area might not be able to contain (SWP-Aktuell 54/2011).

Moreover, discussion about a Greek exit is making the recovery process far more difficult. As long as leaving the Euro area is regarded as an option, capital will not flow to where it is needed to strengthen the economy. In private enterprise there is a liquidity squeeze: businesses are not being granted credit, for buying in stock for example. They can no longer give the required securities. Fresh investment to increase production is not materialising, as growth prospects are non-existent. If investment is taking place, then it is mostly for re-configuring production in the face of disappearing sales markets. Thus investment is doing nothing to increase GDP.

Foreign companies are reluctant to invest directly. Prudent management of business capital is understandable. Converting the currency from euros to drachmas could bring with it a drop in the exchange rate of 50 to 70 percent. Losses in the value of invested capital would be just as high. Discussion about leaving the euro may also be making it difficult to access the capital of public investment banks, as the risk of loan repayment defaults is seen as too high.

In order to avert a self-fulfilling prophesy, it is imperative that both the new coalition government in Athens and Greece's partners in the EMU silence "Grexit discussions" immediately. This implies that both sides acknowledge that the process of transformation will take ten to twenty years and must be supported financially. Meanwhile, the donor countries should allow for some flexibility with regard to the Greek adaptation programme – without easing pressure on Athens to reform. It must be clear that the troika will withhold loan tranches if requirements are not met. A default is a possible option, and this even more so now that bank recapitalisation has progressed. The insistence on reforms and sound public finances is an important signal both to Greek policy-makers and to the political leaders and opposition in other crisis countries not to hinder reform progress.

Still more important is the need to support modernising processes within the country and to establish prospects for growth and reform, not least in order to improve investment conditions.

Reform from below

Deep, necessary reform can only have a sustainable effect if it is formulated within Greece itself. It should focus on the capability and commitment of local political, business and corporate entities to innovate. These are the bodies regarded as acting with legitimacy. Incentives for progress must be awarded, regularly monitored and made transparent. Any failure to make progress must have negative repercussions and, in contrast, a particular zest for reform and innovation should have positive consequences.

One approach that meets these criteria would be to set up "special modernisation zones" in Greece. The basic idea is that communities would be able to apply for the status of a modernisation zone to a project board to be established (see p. 4), which, if the application were successful, would bring them tax exemptions and assistance with reform and modernisation.

In these zones, administrative bodies would be re-structured, if needed with external support, to enable the collection of taxes, guaranteeing legal standards and minimising corruption. A reduction in the patronage resulting from the close intertwining of politics and administration would be part of this. Greece's large political parties award jobs with preference given to those belonging to the political camp in power at any one time. This has contributed to the excessive growth of the public sector as a "care institution". The quality of administrative bodies has suffered as a consequence: this system of spoils leads to the recruitment of insufficiently qualified staff. For the capability of its executive performance, Greece demonstrates the worst score of all OECD countries (cf. *Bertelsmann Sustainable Governance Indicators 2011)*. Many well-educated Greeks have left the country because of this. In order to anchor the transformation process within society, their potential should be mobilised.

Within the framework of the modernisation project, assistance would also be necessary in investment planning, in education and infrastructure development. Local authorities would also be given advice when calling upon structural funds and in applying for loans from development banks.

With elected decision-makers having to apply for the status of special modernisation zone for their municipality, the problem of ownership, which is only too well-known in externally promoted top-down development processes, would be reduced. Local political leadership teams would not be replaced by a technocratic board or made de facto impotent, as is now the case under the troika programme at national level. They would be responsible for the implementation of their own project and required to collaborate constructively with external supporters.

This support network could consist of Greek EU officials or civil servants on sabbatical, specialist administrators or advisers from other member states, as long as foreign language competences are available in the local authority. Relevant experience in this type of approach exists from twinning and TAIEX programmes, which function in a demand-led manner. Local authorities would have to formulate concrete requirements for staff and expertise, whereupon the network would be scanned for suitable support.

Furthermore, a "Business Angels for Greece Network" could make entrepreneurial know-how available. In particular, it may provide practical support for start-up businesses and founders of businesses and initiate contacts with investors. This NGO, which is yet to be established and which could build on existing networks, would initially be directed at the modernisation zones. There is anecdotal evidence that a number of Greek protagonists are already becoming more involved in the development of their own country. With the “Give Greece a Chance” campaign, thirty international companies have spoken up, referring to the dynamics already in place and calling for joint commitment.

Growth through Investment

If tax revenue is generated in the special modernisation zones as a result of the measures taken, only a proportion would be paid into the national budget. The rest would be reinvested in the region in growth-promoting projects (infrastructure, education). The requirement to expand the project geographically could be tied to this. Neighbouring local authorities could be linked in with a form of twinning. For instance, communication and transport infrastructure could be expanded in the geographic vicinity. If geographic spread is not a stated aim, the proportion of tax revenue remaining in the region will reduce. In addition, innovative approaches to financing, such as the construction of town development funds, are to be examined and developed further. At the beginning of 2012 the European Investment Bank, together with the EFG Eurobank Ergasias, the Investment Bank of Greece and the Piraeus Bank, launched the first project of this kind and made 158 million euros available for town development projects with the aim of improving competitiveness, social integration and sustainability in selected towns. Growth funding could also be accessed from the EU, focusing regular regional and cohesion funding mechanisms on the modernisation regions as a one-off emergency measure – as long as implementation were ensured as part of the modernisation process.

Guaranteeing Coordination

Although the basic principles of modernisation zones are decentralisation and individual initiative, coordination is needed at national level. In the past two years, support efforts have multiplied. Now it is a matter of evaluation, focusing on common goals and fine tuning.

The European Commission’s Task Force on Greece could support the introduction and implementation of the bottom-up approach, in particular during its initial phase. A first step should be the setting up of a project board comprising Greek representatives from politics, business and civil society, as well as some representatives of the EU institutions and other member states. Their task would be to establish the overarching structures for this new policy approach with like-minded Greeks. The initial task would be to set out the objectives of the new approach, whilst maintaining autonomy in decision-making and responsibility at local levels.

The board would moreover be responsible for awarding special modernisation zone status and would have to evaluate progress regularly. It would also establish the necessary supporter networks. In the operative phase, a series of round table meetings could define joint standards and information flows. Furthermore, bilateral initiatives at political and non-state level (such as between business associations, town partnerships, in the civil society arena etc.) should be included. German political foundations, which have once again been active in Greece since 1 March 2012, could mobilise forces within civil society or support the founding of new organisations, which have committed to social and economic modernisation.

Finally, all actors involved should continue to promote public discussion regarding the country’s prospects in the EU and the need for deep-rooted reform and modernisation. This is essential, as Greece even after the June 2012 elections, continues to face difficult political and social challenges.

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ISSN 1861-1761

Translation by Kiersten Sparke

(English version of SWP-Aktuell 15/2012)