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Greece: A Crisis of Governance

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Bonn, *6 February 2012*. While Greece is edging closer to a haircut on its sovereign debt, calls for Greece leaving the eurozone are getting louder. Granted, an exit from the eurozone and subsequent devaluation of a New Greek drachma could help Greece recover the competitiveness it has lost within the monetary union over the past decade, at least in the short term. But an exit from the eurozone would fail to address any of the three fundamental problems that bedevil the Greek economy. These are a completely dysfunctional fiscal system; a massively overblown, non-transparent and inefficient public sector; and endemic corruption. None of these problems have anything to do with Greece's membership in the European monetary union. Abandoning the euro would therefore provide no remedy to the Greek tragedy. At best it would provide temporary breathing space for the Greek economy, although not even this can be taken for granted given the disastrous effects a euro exit would have for the country's financial sector.

Greece's fiscal woes ought to be seen in the context of the country's very fundamental governance problems. Entry into the European monetary union gave Greece the credibility its weak institutions did not have before and membership in the exclusive euro club was perceived as a sign of trustworthiness. The borrowed credibility gave Greece cheap access to international capital markets and the chance to pile up enormous amounts of debt. Unfortunately, the country's political and economic elite did not honour the trust placed in them. A look at the World Bank Governance Indicator for corruption, for instance, shows that already years before the crisis, Greece could be grouped together with countries such as Cuba, Malaysia, Namibia, Jordan – and Italy. Transparency International ranks Greece at a similar position, reflecting the country's structural governance problem. Accompanying in-depth country reports by Transparency International and other watchdog NGOs have been filled with cases of rent-seeking, corruption, and political favouritism. Even worse, the World Bank Governance Indicator for corruption has been deteriorating steadily since Greece joined the euro in 2001.

For sure, challenges of political transparency and accountability are found everywhere. But there are large differences between societies – even among OECD countries. And those differences impact heavily on economic development. As shown by one of the pioneers of political economy – Mancur Olson – more than a decade ago, high levels of corruption and insecure property rights strongly impact on the total factor productivity rate of an economy – the standard measure of an economy's long-term technological dynamism and competitiveness. Accordingly, to improve the competitiveness of its economy, Greece urgently needs to address its governance problem. Moreover, any attempts at fiscal consolidation will be futile if the governance problem is not dealt with. A European "budget commissioner" would hardly make a difference and only cause anti-European (and anti-German) resentment. Greece needs governance reform, not just austerity.

The discussions on how deep fiscal adjustment could reasonably be without completely choking off hopes for economic recovery have largely failed to take account of the governance dimension. What matters is not simply the amount of fiscal spending but whether money is spent wisely. Cutting wasteful government spending that feeds a corrupt system will benefit economic recovery. In contrast, curbing social services that will deplete the incomes of those already on the brink will further reduce consumption and – also very important – erode political support for structural reform. Increasing the quality of fiscal spend-

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ing in the long run needs transparent and accountable public financial management. Thus, efforts to achieve fiscal consolidation will not be sustainable if the issues of transparency, efficiency and accountability of the state apparatus are not addressed.

The European Commission, the International Monetary Fund and countries willing to help Greece should condition their help much more than before on improvement in public administration. To this end, they can draw on the relatively successful experiences made in international development cooperation over the past years. Under the name of General Budget Support, systemic financial support of bi- and multilateral donors to poorer countries comes along with a special focus on public financial management. Thus, financial support is conditioned to improvements in fiscal transparency as well as to strengthening independent oversight institutions such as the General Auditor's office. Moreover, the recipient country is expected to increase the supervisory role of parliament and civil society in order to improve the accountability of the executive. Such conditions attached to external financial support are not only aiming at reducing the fiduciary risks of external supporters but to promote a more functional and efficient public sector.

Political conditionality attached to financial support will of course only facilitate governance reform and needs to be based on strong domestic coalitions within the Greek society. For the Greek society to embrace such reforms, the country needs a growth perspective. Germany, among all countries, should remember the economic support it received after the Second World War from the US government and throw its weight behind a European long-term investment plan for Greece. Besides using the EU's Structural Funds, the European Investment Bank, the European Bank for Reconstruction and Development and also the World Bank should launch a coordinated investment programme that will help boost employment and lay the foundation for sustainable growth.

To put the Greek economy and Greece's finances on a sound footing, the county urgently needs to address its governance challenges. This is probably achieved easier within the eurozone than outside. Either way, it will be a challenge that cannot be fixed in the short term. And those willing to support Greece on this stony path should make clear that they do not only expect economic but also political changes. Addressing Greece's governance challenges is important for the country. Yet it is as important for the eurozone since the weakest link in the system undermines the credibility and hence stability of the entire monetary union.

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