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GREECE'S INSTITUTIONAL TRAP

BY ARISTIDES N. HATZIS[1]

The root cause of the Greek Crisis was the institutional deficit, i.e. the lack of an efficient institutional framework that is necessary for economic growth. The crisis of 2008 was the triggering effect of the perfect storm that hit Greece in early 2010. Unfortunately, the austerity enforced by the three bailout programs treated only the symptoms by emphasizing fiscal consolidation. By ignoring the root-causes, the bailout agreements underemphasized, in practice, structural reforms. The intuitional deficit in Greece has many aspects: a closed economy, overregulation, low-quality regulation, selective enforcement, high transaction and administrative costs, delays and inefficiencies in processing judicial cases, over-development of inefficient social norms and underdevelopment of efficient social norms. We adopt the Acemoglu/Robinson framework to emphasize the need for Greece to replace its extractive institutions with inclusive institutions suitable for economic growth. This transition is politically difficult since Greece has fallen into an "institutional trap": Powerful groups are using their political power to preserve their rents, undercutting any reform and the adoption of inclusive institutions. The result is the perpetuation of the crisis, an economy which still is the least free in the European Union, half-baked reforms and reform-fatigue after 8 years of harsh austerity.

Keywords: Greek Crisis; Inclusive and Extractive Institutions; Rent-Seeking; Transaction Costs, Overregulation; Social Capital; Formalism

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The Greek Crisis is usually discussed in connection with three different deficits: the budget deficit (15.4% of GDP in 2009), the trade deficit (14% of GDP in early 2008) and the current account deficit (14.7% of GDP in 2008).[2] These three deficits reached record high numbers after the crisis of 2008 and the erratic reaction to it by the conservative government of Kostas Karamanlis (2004-9) and the social democratic government of George Papandreou (2009-10). The collapse of public finances in early 2010 and the ensuing damage to the Greek economy from the dismal expectations, the liquidity problems and the skyrocketing interest rates for sovereign bonds, led to the first bailout agreement in May 2010. However, Greece's dismal indicators in 2010, but also in 2018, are not the end of the story. One should identify the root-causes of the poor performance of the Greek economy elsewhere. Because the three deficits and the gigantic public debt (142.8% in 2009, 177.4% at the end of 2017) were only the symptoms.

We believe that the most important deficit in Greece in the late 2000s was the institutional deficit. By "institutional deficit" we mean the lack of an efficient institutional framework that is necessary for economic development. Greece lacked this institutional framework in 2009 and it still lacks it today.

After 8 years of very harsh austerity, consisting mostly of fiscal measures, esp. tax hikes, Greece managed not only to consolidate its public finances, achieving the largest primary surpluses in Europe but also to lower labor cost impressively. However, the achievement of major fiscal adjustments and the steep decline in labor cost was not enough to attract FDI, lead to a strong recovery, and help Greece exit recession. The reason for the stagnation is that the three bailout-adjustment programs, were mostly treatments of the symptoms and not of the root-causes of the crisis. Greece is still a closed economy with a serious institutional deficit: it lacked this institutional framework in 2010 and it still lacks it today. This is the primary reason why Greece, after three bailout agreements, painful adjustment programs and an impressive fiscal

[2] Due to a combination of a rising domestic demand growth and declining external competitiveness. Over the 2000-9 period external trade declined from 25 to 19% of GDP.

consolidation is still in crisis, without signs of a solid recovery. Institutional deficit in Greece has many different aspects: overregulation, low-quality regulation, selective enforcement, high transaction and administrative costs, delays and inefficiencies in processing judicial cases, over-development of inefficient social norms and underdevelopment of efficient social norms. Therefore, in "institutional deficit" we include seemingly contradicting phenomena like institutional atrophy and institutional rigidity but as we will see this makes sense in a legal system which is at the same time formalistic and inefficient.

Greece must replace its extractive institutions with inclusive institutions suitable for economic growth. It is very difficult for Greece to transition to more open institutions because of the phenomenon of "institutional trap". Powerful groups are using their political power to preserve their rents and the Greek political system doesn't seem resolute to cut this Gordian knot. The result is the perpetuation of the crisis which has been now very close to a decade, with an economy which still is the least free in the European Union, half-baked reforms and a reform-fatigue after 8 years of austerity, all of which made the situation even worse.

In the following sections, we are going to introduce some basic terminology and concepts and then we are going to briefly present the four aspects of Greece's institutional deficit. We will attempt to explain the deficit by using the concept of "middle-income institutional trap" introduced by Daron Acemoglu. We will then propose a number of solutions to these problems based on the literature of institutional economics (Furubotn & Richter 2005).

I. Formal and Informal Institutions

Institutions, in this context, are rules, norms and structures which govern but also influence individual and social behavior. Institutions are connected to the human experience since the dawn of the first civilizations. However, only recently, their importance for economic growth has been widely explored, analyzed and appreciated.[3] Institutions are also the fabric of society. They are important for social cohesion, they are part of social capital and they support social interaction. Institutions exert an enormous effect upon individual behavior since they can be repressing but also empowering. Institutions can be linked (or not) to social morality, the prevailing religion or to an official ideology. However, in every part of the world their main function is to ensure social order and economic prosperity. If a particular national institutional framework cannot serve one of these two functions, it is considered failed. In extreme cases of institutional failure, the countries concerned are characterized as failed states.

Institutions can be categorized in many ways. However, the major distinction, which is also crucial for our purposes, is between formal and informal institutions. Formal institutions are mostly the legal rules, i.e. laws, statutes, executive decrees, regulations and judicial precedent (in common law countries but in civil law countries as well, esp. where the doctrine of *stare decisis* is highly valued). Legal rules constitute the legal system, they are promulgated by a government branch (legislative, executive, judicial) and they are enforced by the state. Sometimes it's not so easy to characterize a rule as legal or not. However, it is widely accepted that marginal cases like soft law, arbitration decisions, contract terms, codes of ethics etc. can be characterized as quasi-legal rules if they are enforceable in a court of law. Usually we identify institutions with formal institutions and the institutional framework with the national legal system. This is a major mistake. Informal institutions are as important as formal institutions.

Informal institutions are mostly social norms. These norms are not backed by the state's legitimate threat of force. However, their violation can lead to social sanctions or at least can be costly for the offender. Social norms are, in fact, the core fibers in the fabric of society. They are usually linked to conventional (social) morality but also to as diverse types of norms as trade usage, business ethics, level of trust, community standards, level of civic participation, customs and traditions and any kind of norms internalized in the process of socialization or integration into the broader society or a particular social group. Social norms are usually internalized by the majority of a population and one's observance to them is almost automatic.

[3] See the rich literature from Coase (1960), to Olson (1971; 1982) and North (1990), masterfully summarized by Acemoglu & Robinson (2012). See also Mantzavinos (2001).

Rule following, esp. when this rule is a social norm, resembles a behavior guided by a heuristic. It is not an exaggeration to say that social norms can become "social heuristics", guiding behavior as innate rules of thumb.

Social norms, quite often, are more constraining than legal rules. Their most important function is, thus, to serve as the infrastructure for the legal system. There can be no formal institutional framework without the backing of the informal institutional framework. Their entanglement is not only the result of problems in conceptual categorization of different types of institutions or the complexity of any institutional framework but the very fact that informal rules are the substructure of a legal system. Without a strong foundation the legal system, the political order and of course the economic order will be easily shattered. As we are going to see the following paragraphs, the Greek legal system is not based on a solid informal institutional framework. And this is the most critical aspect of Greece's institutional failure.

Social norms are crucial for economic development. Efficient social norms can serve as transaction cost-saving mechanisms (Posner 2000). Trust is the typical example. A market with a high level of trust can greatly economize on administrative and transaction (esp. bargaining, monitoring and enforcement) costs. On the other hand, inefficient social norms are increasing the transaction cost. Trust is again the typical example. A market with a low level of trust will suffer of high transaction and administrative costs which usually lead to bureaucratization, legal formalism, a surge of disputes[4] and at the end of the day, less transactions per capita, less surplus, less efficient allocation of resources, less growth, less wealth.

According to Mancur Olson (1982), an efficient institutional framework is as important for economic growth as an open market. The long-term benevolent effects of an open market are dependent on the efficiency of the institutional framework which regulates and supports economic activity. Nevertheless, it is a mistake to see the two as independent variables working in parallel. For the purposes of this chapter an open market is not an unregulated free market

[4] See e.g. the influence of the erosion of social norms to Ancient Athenian legislation in the years of decline, after the end of the Peloponnesian War, in Karayannis & Hatzis (2010).

with no rules, but a well-regulated market supported by the rule of law, efficient legal rules and a set of indispensable cost-saving social norms, mostly high levels of trust.[5]

A free market without an efficient legal framework will inevitably lead to crony capitalism. A low-quality regulatory framework will inevitably lead to both overregulation and underregulation. An inefficient institutional framework instead of correcting market failures, it creates major government failures. Government provision of public goods transmutes to rent-seeking. Redistribution does not eradicate poverty, but it becomes a clientelist apparatus, benefitting the socially and/or economically powerful. And the welfare state instead of providing a safety net, alleviating poverty and offering social benefits to people in need, it grows to be a political spoil for formidable pressure groups. Greece is, again, as we are going to see, a textbook example of this kind of institutional failure (Hatzis 2012).

II. Inclusive and Extractive Institutions

A categorization which is extremely useful is the one made by Acemoglu & Robinson (2012) in their celebrated book *Why Nations Fail*. According to the authors economic prosperity is the result of high-quality institutions (which are called "inclusive") and poverty the result of low-quality institutions (which are called "extractive"). Inclusive institutions give the right incentives to people and societies to invest, innovate, adopt new technologies and cooperate. They encourage creativity and entrepreneurship and they boost productivity. They ensure a more equal distribution of income.

There are many types of inclusive institutions. However, the most important of them are (1) the effective protection of property rights, (2) the full and speedy enforcement of contracts, (3) an efficient intellectual property law (giving incentives to innovation without prohibiting the dissemination of technology), (4) an efficient insolvency law, (5) a legal framework for

[5] "Markets, left to their own devices, can cease to be inclusive, becoming increasingly dominated by the economically and politically powerful. Inclusive economic institutions require not just markets, but inclusive markets that create a level playing field and economic opportunities for the majority of the people." (Acemoglu & Robinson 2012: 323)

investor's protection, an easy and cheap procedure for starting a business and encouragement of entrepreneurship, (6) low transaction and administrative cost, (7) a high-quality regulatory framework, (8) open competitive markets without artificial barriers to entry (due to regulation or oligopolies), (8) a rule of law with clear separation of powers, protection of rights and constitutional checks and balances, (9) a society of order and security, (10) an efficient adjudication system with developed alternative dispute resolution mechanisms, (11) public infrastructure which is necessary for economic development and (12) access to education and health but also opportunities for the citizens.[6] It goes without saying that only liberal democracies can have adequately inclusive institutions. According to Acemoglu and Robinson inclusive economic and inclusive political institutions are interrelated. Inclusive political institutions support inclusive economic institutions and vice versa. Inclusive institutions empower a broad segment of society not cronies, political and economic oligarchies and strong distributional coalitions.

Extractive economic institutions do exactly the opposite. They create disincentives to investment, innovation, adoption of new technologies and cooperation. They discourage creativity and entrepreneurship and they decrease productivity. The rule of law is underdeveloped, or its basic principles are violated (property rights are not adequately protected, and contracts are not enforced in a timely manner), there is no order and the political system is corrupted. Usually there is a strong entanglement of politically and economically powerful groups and cronyism. Clientelism with barriers to entry in order to protect the cronies from competition and overregulation in order to stifle competition and innovation are the elements of a corrupted corporatist model, usually identified with crony capitalism or third world authoritarian regimes.

Of course, the categorization of a particular economic and political system is not straightforward. Each country has a diverse mix of institutions which are not entirely inclusive or extractive. Even the countries who are recognized as the ones with the more inclusive institutions in the world (Scandinavian countries, Canada, the Netherlands, etc.) have institutional blind spots and even the most authoritarian systems have traces of inclusive institutions. Even

[6] This is a modified list based heavily on Acemoglu & Robinson but with several alterations/additions.

though there are a lot of grey areas, most of the times one can determine rather easily the nature of a political and economic system as being an inclusive or exclusive. Greece is rather a tough case since it is a country with a long tradition of extractive institutions but also with inclusive institutions in some crucial areas (Kalyvas 2015).

III. The Institutional Trap

To better understand Greece's institutional deficit, we are going to adopt the very useful conceptual tool of the "institutional trap". A country which falls into this trap is a country who has managed to develop for many years, if not decades, with extractive institutions. Economic growth led this country, usually, to a middle-income status which was often the result of some partial liberalization of the economy and integration to the globalized economic system. Usually such a country has a corporatist model of development, with powerful government monopolies and government-protected cartels, a strong clientelist political system which is protective of strong pressure groups and anyone who works for the government. The quality of the rule of law is average or low, there is a suboptimal protection of property rights and contracts and the regulatory framework creates more administrative costs than it saves in transaction costs. The innovation is minimal, and the technology is imported. Businesses are dependent on the state for subsidies, they are targeted toward the internal market and exports are discouraged.

The level of inequality is high, and this creates a strong demand for redistribution which the government satisfies it in some degree, profiting politically, at the same time. Social benefits are presented as political favors which are given in exchange for votes. There is equilibrium in this system since economic growth and redistribution ensures that society is satisfied.

However, this system reaches its limits when further economic development cannot be based on extractive institutions. To return to growth the government should make bold reforms, introducing inclusive institutions and getting rid of the extractive institutions. The problem is that this course (upsetting the balance of power and introducing new rules for the game) is politically costly for any government. The reaction of the strong pressure groups is fierce since they realize that inclusive institutions will undermine their narrow interests. They create obstacles to the government from lobbying to street protests which lead, very often, to the government's disorderly retreat. Under the fear of losing power, the government compromises by making concessions to powerful pressure groups trying at the same time to save face by introducing minimal, politically non-toxic, reforms. But this also means that extractive institutions stay in place and genuine inclusive institutions are not suitably introduced.

This deadlock is called institutional trap because the economy becomes stagnant or deteriorates since further growth is impossible without replacing extractive for inclusive institutions as needed. It's a limbo state that is simultaneously precarious and non-sustainable, esp. since the undermining of reforms has repercussions such as underinvestment, disincentives for innovation and economic stagnation.

The idea of a middle-income trap is older than the Acemoglu reformulation.[7] Most economists see the middle-income trap as the end of an era of competitiveness in developing countries which, after a period of rapid development into a middle-income status, fail to upgrade to high value-added markets. The investors are not interested in these countries anymore (since the middle-income status means rising wages), the productivity is low (since their development was based on a pool of cheap unskilled labor which is now exhausted) and they cannot maintain export growth while at the same time the new middle class prefers to consume imported goods. Acemoglu reformulates this idea by emphasizing the institutions under which a country reached the middle-income status. These (extractive) institutions are a liability now. The difference between Acemoglu and the rest of the middle-income trap literature is that

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[7] The idea of middle-income trap was introduced in 2007 by two World Bank economists, Indermit Gill and Homi Karas (2007: 17-18; see also 2015 where they emphasize the need for "a transition to more mature institutions"). The concept became popular mostly with World Bank and IMF economists who elaborated on the idea. Acemoglu's idea of middle-income *institutional* traps is still unpublished (but see the influence on World Bank 2017: 160). My discussion is based on his conference presentations and slides he kindly shared with me. However, the first insight can be found in Acemoglu & Robinson (2006). Gradstein (2008) had a similar idea of "institutional traps" (what prevents societies from adopting superior institutions and why do so many less developed countries seem to be stuck in a bad equilibrium with low-quality institutions and poor economic outcomes?), very much influenced by Sokoloff & Engerman (2000) historical analysis (where there existed elites who were sharply differentiated from the rest of the population on the basis of wealth, human capital, and political influence, they seem to have used their standing to restrict competition). See also the seminal ideas in Olson (1982). Acemoglu worked on the idea of middle-income institutional trap having India and Turkey as models.

the latter emphasizes investment in human capital, innovation and technological infrastructure while Acemoglu seems to believe that inclusive institutions are a *sine qua non* condition for the transition to high-income levels.

IV. The Greek Case

As we mentioned in the beginning Greece is the textbook example of an institutional trap. Greece's growth was impressive for many decades. From 1929 to 1980, Greece had an average annual rate of growth of income per capita of 5.2% (during the same period, Japan had an average of 4.9% and Germany 3.0%), despite the fact that the period from 1929 to 1974 was a period of wars, dictatorships and anomalous political situation. When Greece entered the European Communities in the early eighties its public debt was only 28% of GDP, its deficit less than 3%, the share of GDP for exports of goods and services was 26%, there was low unemployment and the growth rate was more than decent (averaging 4.9% from 1974 to 1979). High inflation (~ 25%) was the result of the second oil crisis.

Nevertheless, Greece had significant structural problems, principally an inefficient agricultural sector, numerous and inefficiently organized small and medium-sized enterprises and an inadequate welfare state. Despite the sluggish 1980s (0.8% average growth from 1980 to 1994) and the surge of public debt (more than 112% in the early nineties) Greece managed to return to growth after adopting a limited number of reforms and reluctantly liberalizing its economy during the 1990s. Its growth exceeded the average in the Eurozone from 2000 to 2009 (4% from 2000 to 2009) and the income gap with the other members seemed to disappear (95% of the EU average in 2008) while private spending impressively surpassed it (12% more than the EU average in 2009).[8] GDP per capita reached almost $32,000 in 2008. Greece became the 25th country in the world in per capita income and 22nd in the world in the more inclusive index of human development and quality of life in 2010. But the size of the government sector had jumped from 29% of GDP in 1981, to 44% in 2000 and to 53% in 2009 and public debt to GDP was stabilized in three-digit numbers, reaching the formidable 142.8% in 2009. This was a

[8] This was mostly the result of a shadow economy and tax evasion.

(heavily) borrowed prosperity. With less than half of the population in the labor force (47%), with an estimated size of the unreported economy at 25%, with government spending €10,600 per person on social benefits and receiving only €8,300 per person in taxes.

One could argue that Greece is not a middle-income country since it reached high-income status and even today, after many years of a ferocious crisis and a loss of a third of the disposable income of its citizens, Greece is still considered upper-middle – it's not the typical middle-income country. However, as we saw, this was a borrowed prosperity. Greece, as we implied earlier, has many similarities with high-income countries, esp. in human capital and technological and managerial resources but also in living standards, a stable democratic political system for more than four decades and a solid liberal constitutional order. In addition, Greece is a member of every privileged club on the planet (from OECD to EU and the Eurozone). However, its high-income level and its economic convergence was not the result of high productivity, innovation, a generous investment in human capital, reforms and high-quality inclusive institutions. The Greek story is even more interesting if we consider the fact that, as we emphasized, Greece was for several years a success story. It was one of the few countries which, according to the World Bank, managed to escape from the middle-income trap.[9]

Nevertheless, Greece's predicament is identical with the one we described above as the institutional trap. Even if we don't take into consideration the fact the Greece's high-income status was a mirage or at least non-sustainable, we must admit that Greece's quagmire is attributable to the lack of inclusive institutions despite the external commitment provided by the EU and Eurozone membership which should make the institutional development technically but also politically and culturally easier and at the same time more credible. And this is an institutional trap because the culprits for the inability to adopt inclusive institutions are powerful actors who can block institutional changes which undermine their positions.

[9] Of 101 middle-income economies in 1960, only 13 became high income economies by 2008: Equatorial Guinea; Greece; Hong Kong, Ireland; Israel; Japan; Mauritius; Portugal; Puerto Rico; South Korea; Singapore; Spain; and Taiwan and China. See World Bank (2013: 12).

V. Greece's Institutional Trap

After 8 years of very harsh austerity, consisting mostly of fiscal measures, esp. tax hikes, Greece managed not only to consolidate its public finances, achieving the largest primary surpluses in Europe but also to lower labor cost impressively: a cumulative decline in average wages of 21% and in relative unit labor costs by almost 17% from 2010 to 2016 (National Bank of Greece 2017: 7). However, the achievement of major fiscal adjustments and the steep decline in labor cost was not enough to attract FDI, to lead to a strong recovery, to help Greece exit recession. This is not only the result of macroeconomic and political uncertainty but also of a still negative economic sentiment. The reason for the stagnation is that the three bailout-adjustment programs, as we emphasized from the very beginning, were mostly treatments of the symptoms and not of the root-causes of the crisis. Greece is still a closed economy with inefficient (extractive) institutions.

The current (first quarter of 2018) recuperation stage is as fragile as the similar one reached in late 2014 and shuttered in early 2015 when the new leftist Syriza government succeeded the conservative New Democracy in power. The imprudent protracted negotiation with Greece's creditors wasted 6 months and it consisted of a dangerous brinkmanship which led to the economically catastrophic decision for the implementation of capital controls. The result was a total defeat in negotiations, a tremendous economic cost and a new (third) bailout agreement. The new adjustment program with strong conditionality was adopted in the summer of 2015. Two summers later, Greek economy is still stagnant with very weak signs of recovery and little prospects for investment.

The reason for the stagnation is that the three bailout-adjustment programs, as we emphasized from the very beginning, were mostly treatments of the symptoms and not of the root-causes of the crisis. Greece is still a closed economy with inefficient (extractive) institutions.

(a) A closed economy

According to almost every ranking, Greek economy is the least free economy in the European Union and the Eurozone. In the 2018 *Index of Economic Freedom* Greece is placed 115th out of 180 countries, in the “mostly unfree” category (and very far from the second to last Croatia, which ranks 92nd). It is characteristic that Greece is second only to Ukraine at the bottom of the European region of the ranking. It ranks as less free than Russia, Moldova and Belarus! Greece’s ranking is equally dismal at the 2017 *Economic Freedom of the World* ranking. Greece ranks 116th out of 159 countries (again, at the mostly unfree “third quartile”). In the same vein, at the 2017-8 *Global Competitiveness Report* Greece ranks 87th out of 137 countries and it is again the last of the EU countries (Croatia at the 74th place). The 2017 *International Chamber of Commerce Open Markets Index* ranks again Greece at the bottom of the EU. Greece is 50th out of 75 economies (Italy ranks 45th) with one of the worst scores in the world in “trade openness”. In the 2017 *Legatum Prosperity Index* Greece ranks 83rd out of 149 in “economic quality” (which includes economic openness and foundations for growth), last in the EU (Croatia ranks 66th).

The only exception[10] to this dismal picture is the 2017 *Doing Business* where Greece is placed at the relatively decent 66th place out of 190 countries in the ease of doing business (Malta is the only EU country with a lower placement, 84th). However, the *Doing Business* ranking is based more on the legislation passed by the Greek parliament and much less on the way this legislation is enforced. As we are going to see, this distinction (law in books / law in action) is instrumental for someone to understand Greece’s institutional atrophy.

It is more than obvious that according to every kind of ranking (and all the above rankings have quite different methodologies and goals), Greece is the least free economy of the European Union and one of the least free economies in the European continent. This is extremely odd for two reasons. (a) As we mentioned before Greece was always a free-market economy, always a part of the West, with a great tradition in trade, commerce and shipping since the early 19th century, and a member of every privileged club of the capitalist world (most prominently the European Union and Eurozone). How does such an economy rank consistently at the bottom of the continent in economic openness and freedom? (b) Greece has enforced

[10] It is an exception in the sense that there was some real progress for Greece in this ranking. In 2010 Greece’s place was 109th out of 183 countries. Greek bailout governments refer regularly to the improvement on this ranking to prove the they have enforced real reforms.

harsh adjustment programs for eight years, since 2010. These programs have included numerous structural pro-free-market reforms. After these eight years Greece is not only considered an unfree economy but its position has even deteriorated! (see especially the placement of Greece in the *Index of Economic Freedom* from 2010 to 2018).[11]

(b) Institutional rigidity: An overregulated economy

There is no doubt that Greece doesn't meet the criteria of a market economy. It is an economy which is still heavily regulated with an inefficient governance. According to a recent OECD study Greece's potential GDP gains from reducing the size of the government are more than 30%![12] According to the Institute for Regulatory Policy Research, from 1974 to 2005, the Greek governments passed 171,600 regulations: 3,430 laws, 20,580 presidential decrees, 114,905 ministerial decisions and 32,585 local government ordinances.[13] According to another study (Sotiropoulos & Christopoulos 2016) during the period from 2001 to 2015, 1,478 laws, 3,452 presidential decrees, and more than 200,000 other executive decrees, were enacted. The result is a very heavy administrative burden. In a 2006 study, Greece was the EU country with the biggest total administrative burden, 5.4% of GDP, when Finland, Sweden and UK had only 1.2% (Boeheim et al. 2006: 140). From 2002 to 2015, 36 different laws about taxation were enacted with more than 1,094 clauses (Sotiropoulos & Christopoulos 2016: 74) and from 1940 to 2014, 884 different laws (63 of them from 2010 to 2014) and almost 5,000 other executive decrees were enacted on social insurance regulation (Sotiropoulos & Christopoulos 2016: 78).

The problem with overregulation is exacerbated by the fact that habitually more than 20% of the regulations are enacted by laws with a different subject than the one of the regulation itself (Sotiropoulos & Christopoulos 2016: 68). These "midnight amendments" introduced in irrelevant legislation is a disgraceful practice for a rule of law. The same goes for the great

[11] Greece fell from a score of 62.70 in 2010 to 53.20 in 2016! However, in 2017-8 Greece's score rose to 57,3.

[12] See Fournier & Johansson (2016: 34, Figure 12, Panel A: Potential GDP gains from reducing the size of the government).

[13] The number of laws reached 4,550 in the Spring of 2018.

number of executive decrees which quite often circumvent the plain meaning of the laws passed by the parliament.[14]

To overregulation one could add:

i. legal formalism, i.e the idea that the law has a solution to every social or economic problem, that law is a closed system where you can find an answer to every question without resort to social sciences – even for issues that are not regulated by existing law (Hatzis 2009.)
ii. a bloated and inefficient welfare state (Hatzis 2012)
iii. high administrative and transaction costs[15]

(c) Institutional atrophy: Beyond the shadow of the law

One of the worst problems for Greece is the non-enforcement of existing law. The most notoious and much-discussed cases are the enforcement of contracts and the ease of resolving insolvency. In both cases Greece's performance is dreadful. The Greek administration of justice is very slow for several reasons. Courts are understaffed, with limited resources, with antiquated rules of procedure and jurisdiction, with no upper limits to postponements, low public sector (and court) digitization and IT adoption, limited use of electronic filing (Mitsopoulos & Pelagidis 2010; Papaioannou & Karatza 2017; Colville 2012).

[14] This practice was escalated after the bailout agreements. The Greek governments managed to essentially nullify many of the reforms passed by the Parliament in accordance with the adjustment programs, by passing later contradictory amendments or distributing circulars with an "authentic interpretation" of the meaning of the law, thus stealthily reversing previous legislation.

[15] Greece was a European champion in administrative and transaction costs in 2007: To start a new business in Greece you needed an average of 30 days and €1,366 to do it when the average for the rest of the EU was 8 days and only €417. For filing taxes you needed 224 hours a year in Greece while in Luxembourg, you needed only 59. Another prominent example was real estate transfers. For the sale of an apartment that had a contract price of €250,000 the parties had to pay to lawyers and the public notary €6,500. The second most expensive country in Europe was Italy, with only €3,245 for a similar transaction. The transaction costs for the sale of a house includes (even today) a heavy tax, a contribution to the lawyer's pension fund and the registry office. Today the situation is better. However, these costs remain very high and this is one of the reasons for the deplorable position of Greece in every economic openness / government regulation ranking.

The result is that you need 1,580 days to enforce a contract[16] and 3.5 years to resolve insolvency! The cost of enforcement is also quite high: 14.4% of the claim for enforcing a contract and 9% of the estate for resolving a bankruptcy (with a recovery rate of only 33.6%). The quality of Greek judicial process is very low (graded 12/18 for contract enforcement and 12/16 for the insolvency framework). Registering property is also difficult: you need to follow 10 different procedures, in 20 days and incur a cost reaching 4.8% of property value! Therefore, World Bank grades the quality of land administration in Greece with 4.5 out of 30! Greece's world rank in registering property is very poor: 145th out of 190 countries.[17] This appalling situation led *Economist* to place Greece in the first place of its daily chart under the provocative title "Where Not to Invest in Europe".[18]

You can find similar bleak evaluations of the Greek legal system in every report from the ones mentioned before. For example, in the 2017-8 *WJP Rule of Law Index* by the World Justice Project, Greece ranks as the country with the third worst rule of law in the European Union after Bulgaria and Hungary. Greece scores low in everything (esp. Absence of Corruption, Open Government, Order & Security", "Regulatory Enforcement" and Administration of Justice – both Criminal and Civil). Greece scores at the bottom not only of Europe but also of the group of countries with similar income rank.

To these problems you should also add:

i. Corruption. According to Transparency International 2017 *Corruption Perceptions Index* Greece is third to last in the European Union (ranks 59th out of 180 countries)[19]
ii. Low quality regulatory environment.

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[16] See the 2018 Doing Business report, p. 163. According to the 2017 report Greece made enforcing contracts easier by amending its rules of civil procedure to introduce tighter rules on adjournments, impose deadlines for key court events and limit the recourses that can be lodged during enforcement proceedings. However, as we emphasized before, this is still "law in books".

[17] See the 2017 *Doing Business* report, p. 209.

[18] *Economist* online daily chart (October 29, 2014). *Economist* used data from the *Doing Business* 2014 report. You can find the chart at: https://www.economist.com/blogs/graphicdetail/2014/10/daily-chart-19

[19] There is of course an improvement from the 2010 rankings (when Greece shared the same place with Colombia, 78th out of 178 countries).

iii. Non-enforcement of laws: a typical example being the non-enforcement of the anti-smoking law in Greece. The law against smoking in public places went into effect in 2009.[20] For almost a decade the enforcement of the law was not simply ineffective, it is was nonexistent. As a result, Greece (according to Eurostat)[21] is first in the European Union in daily exposure to tobacco smoke indoors: 64.2% of its population aged 15 or over are exposed to smoking (with Croatia being a distant second with 44.7%).

In general, there is a chasm between law in books (formal institutions, legal rules, judicial decisions) and their implementation. Even inclusive institutions cannot produce benign effects if they are not enforced or if they are being distorted through implementation. The efficiency of institutions hinges upon the way of enforcement. Law in action is as important in practice as law in books (Pound 1910). An inclusive institutions blueprint (introduced with the adjustment programs) was not enough.

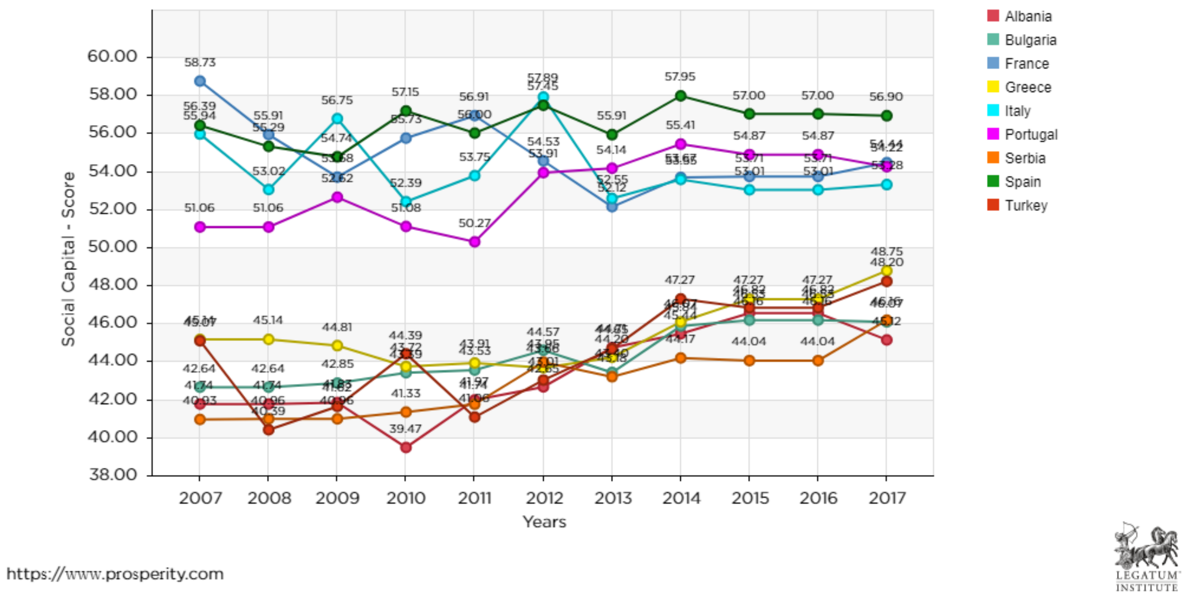
(d) The absence of civil society

Greece had traditionally low social capital. According to the 2008 European Social Survey, trust in Greece was very low before the crisis. 59.8% of Greeks were cautious of other people (in comparison to a 38.8% average in Europe). 62.1% of Greeks believed that most people are trying to take advantage of them if they have the opportunity (in comparison to 28.4% in Europe). A similar 58.3% of Greeks believed that people care more about themselves and they don't care about the others (in comparison to 31.3% in Europe). Participation in all types of voluntary organizations and activities (political, religious, cultural, athletic, professional, business, environmental, pro-consumer etc.) were and still are very low in relation to the European average (see Huliaras 2014: 5). In a 2010 European Union study Greece was classified among countries such as Italy, Lithuania and Bulgaria, where less than 10% of the population above 15year-old took part in voluntary activities, with an EU average of 22% (Sotiropoulos 2014: 4).

[20] It is more characteristic that the law is violated by members of Parliament inside the Parliament building. Even the current Deputy Health Minister smokes in his Ministry during press briefings.

[21] http://ec.europa.eu/eurostat/web/products-datasets/product?code=hlth_ehis_sk4e

The inclusive Legatum Prosperity Index traces Greece's weak social capital for the past decade. The Social Capital sub-index measures the strength of personal relationships, social network support, social norms and civic participation in the country. Greece ranks very low in this ranking. As you can see in the figure below (see Figure 1), Greece's social capital was very low, even before the crisis. It's not comparable with other Southern European countries like Italy, Spain or Portugal but only with Balkan countries.[22]



This is the result of the low levels of trust, of a proliferation of free-riding, of the low levels of cooperation and reciprocity, of high levels of corruption and high levels of tolerance towards that corruption. These are characteristics of a society where statism, cronyism, nepotism and rent-seeking are rewarded. An institutionally immature society which combines institutional sclerosis and institutional atrophy. Where civil society is absent – the term cannot even be translated into Greek.[23] This institutional deficit creates enormous collective action problems, opportunistic behavior, political apathy and distrust to institutions.

[22] The four EU countries with lower social capital than Greece are all Eastern Europe countries: Lithuania, Croatia, Hungary and Bulgaria.

[23] The translation that is used is rather a misnomer: society of citizens (*koinonia politon*). It has a quite different meaning from the one used in the English language.

In a recent major survey of public opinion, the most popular "institutions" in Greece were "family" (97.2% trust it), the Greek Army (81.3%) and the Police (72.2%). Internet (54.4%) is more popular than Newspapers (29.7%) and the Greek Orthodox Church (49.5%) is more popular than the Parliament (42.3%). This is a society that is institutionally immature, almost premodern (Hatzis 2017).

VI. Conclusions

Modern Greece has a history of almost two centuries. During these centuries, the country managed to move from the backwaters of Europe to a prosperous liberal democracy. However, this development was based on extractive institutions and it was undermined by the twin phenomena of institutional rigidity and institutional deficit. The membership in the European Union and the Eurozone helped Greece put its extractive institutions under the rug of European Union convergence funds, cheap international borrowing and fudged statistics. The crisis of 2008 was the triggering effect of the perfect storm that hit Greece in early 2010.

Greece must replace its extractive institutions with inclusive institutions suitable for economic growth. It is very difficult for Greece to transition to more open institutions because of the phenomenon of "institutional trap". Powerful groups are using their political power to preserve their rents and the Greek political system doesn't seem resolute to cut this Gordian knot. The result is the prolongation of the crisis which has been now very close to a decade. An economy which still is the least free in the European Union, half-baked reforms and a reform-fatigue after 8 years of harsh austerity.

I cannot see how this situation can be reversed without some very drastic and politically bold decisions by a Greek government which can understand the need for market liberalization and structural reforms. A government less myopic than the governments which ruled Greece for the last eight years.

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