# Section II

# 정책논단

# The Mismanagement of the Greek Economy and Some Contrast with Korea[1]

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## 1. Introduction

During the recent global financial crisis, Greece has been the target of much attention as its economy found itself at the brink of total collapse and needed much intervention from IMF and the EU to survive. Many changes took place in this country in the last few years, mainly as its international lenders requested to the Greek governments to rationalize and better manage its economy and society. In April 2014, Greece was able again to borrow from free markets in order to fulfil its financial commitments. In this brief paper we can pinpoint at the main issues responsible for Greece's mismanagement of its economy since the 1980s.

In order to carry out our analysis we first need to succinctly suggest a couple of scenarios which theoretically can serve as the basis for our arguments. In the first scenario, we initially have a sudden increase in employment by arbitrary hiring people in the unproductive public sector; this leads to a decrease or deceleration of labor productivity. Consequently, prices and interest rates increase which in turn cause a decrease or deceleration in investment. The end result of this chain of reactions can be a reduction in or deceleration of production, increase in unemployment, and an overall stagflation [Olson (1982)]. In the second scenario, consecutive increases in budget

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deficits may push the wages up (hence these wage increases are not in accordance with productivity changes). In turn, prices increase and the remaining steps are similar as the steps of the first scenario. Note that multiplier effects due to increases in employment and wages take time to be effective, and hence inflation sets in first and then overall stagflation

In Greece both the above scenarios took place in the last 50 years, but in South Korea they did not. We will look at some contrasting points for these two countries whenever possible.

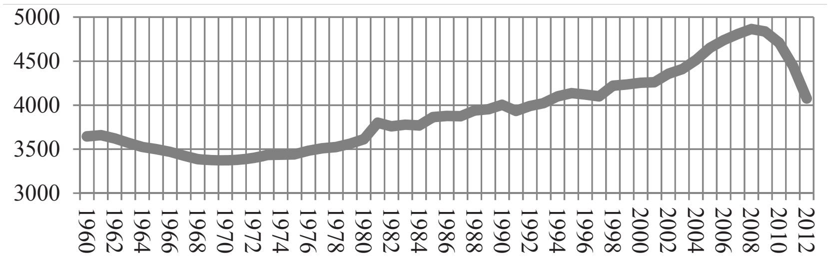
## 2. The main changes in key factors

We will follow the scenarios as presented in Introduction. First, as we can see in <Figure 1>, total employment suddenly increased in 1981by about 200000 and then it was steadily increasing thereafter. The increase from 1981 up to 2000 in total employment(2) was about 600,000 and from 2001 to 2008 it was about 600,000 again, a total increase since 1981 of about 1,200,000 employees. From 2009 to 2013 the drop was about 900,000 thus in 5 years offsetting most of the 1,200,000 increase from 1981 to 2008. This drop of about 900,000 is the employment bubble that the Greek governments created since 1981; a huge part of this bubble was absorbed by the inefficient public sector (both government services and public companies).

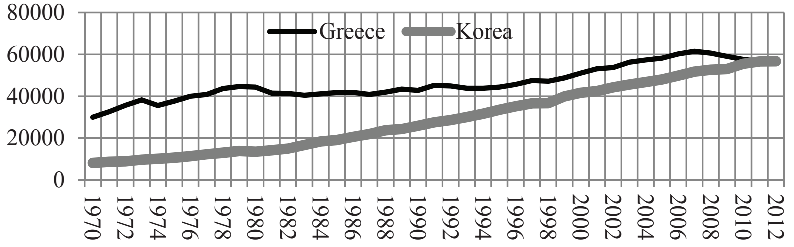
As predicted by our first scenario, labor productivity in Greece dropped or remained constant from 1981 to about 1995(see <Figure 2>). On the contrary, Korea did not face such a problem since employment increases were solely due to real demand for labor in the productive industrial sector.

At the same time, and according to our second scenario described in Introduction, wages increased well above productivity. This is summarized in <Figure 3>, where the nominal unit labor costs (ULC) which are the ratio of compensation per employee to real GDP per person employed (or PLCD in AMECO database) are shown. As predicted,

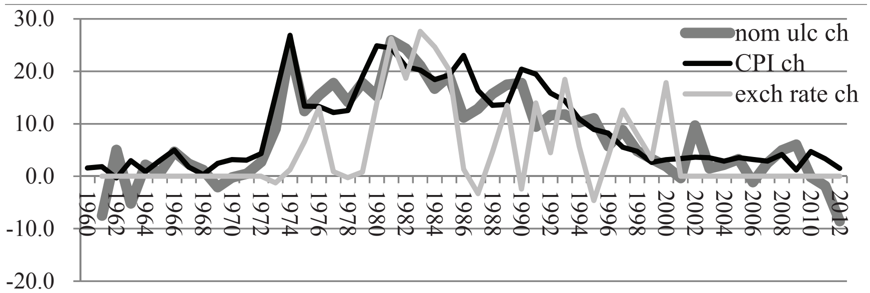
(2) The data are based on the official European sources of AMECO, OECD, and World Bank.



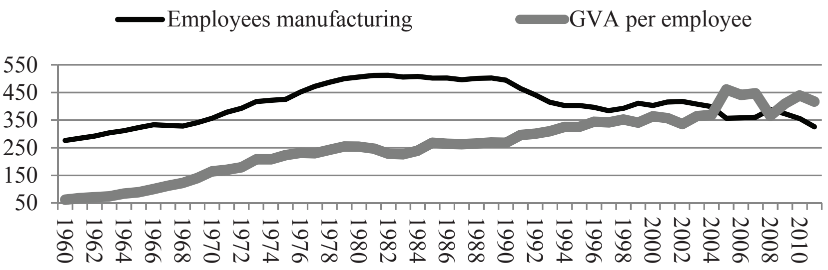

**<Figure 1>** Total employment in Greece



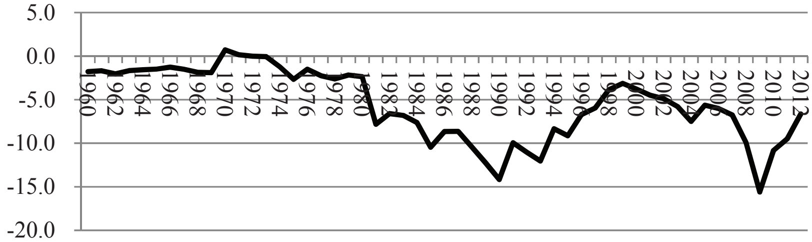

**<Figure 2>** Labor productivity in Greece and Korea



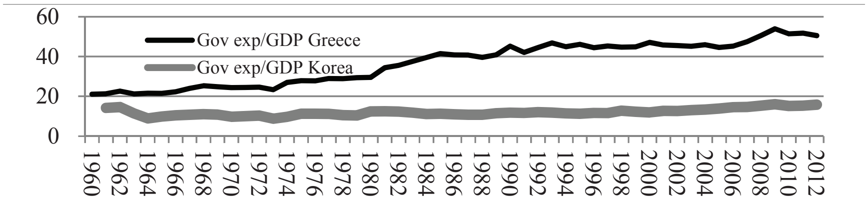

**<Figure 3>** Price changes in Greece




**<Figure 4>** The manufacturing sector in Greece (in ,000 for employees)



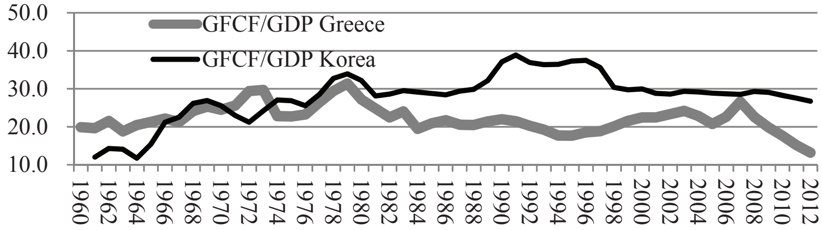

**<Figure 5>** Budget deficits in Greece (as %)



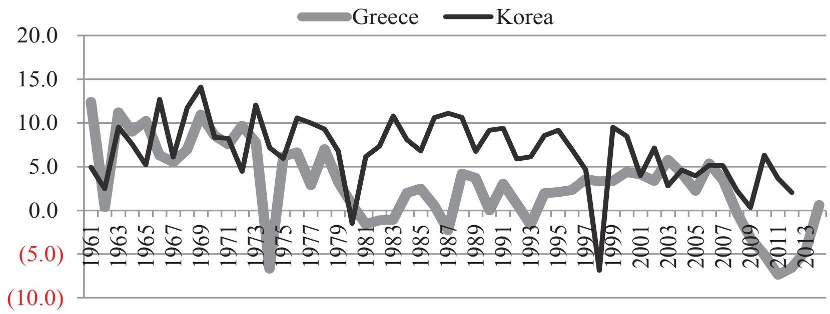

**<Figure 6>** Government expenditure over GDP ratio for Greece and Korea (as %)

inflation sets in together with wages higher than productivity (ULC). It took 18 years for inflation to go below 5% again. Since 2009, wages and ULC decreased thus correcting the wage bubble accordingly.

The maneuvered increase in W/MP (ULC) and P was the most undesirable event for the development of Greek industries and in particular of the Greek manufacturing industry, since we know from basic economic principles that increases in wages above productivity and prices (at least prices of intermediate goods) entail a decrease in local Greek supply or production of goods (see <Figure 4>). On the contrary, wage increases did not "harm" the services sector (mainly governmental services) which was subsidized by increasing government borrowings. Again, the de-industrialization of Greece started in 1981 and lasted for at least one decade. Then slowly it picked up in the 1990s and its productivity increased. However, today there are still some healthy industries and the prospects are good for more industrialization again. The huge increases in employment in the public sector and wages occurred because of increasing budget deficits, which starting from 1981, were generated by heavily borrowing in international markets (see <Figure 5>). Nonetheless, we can see that when the government wanted to enter the EU,




**<Figure 7>** Investment over GDP ratio in Greece and Korea (as %)




**<Figure 8>** GDP real growth in Greece and Korea (in %)

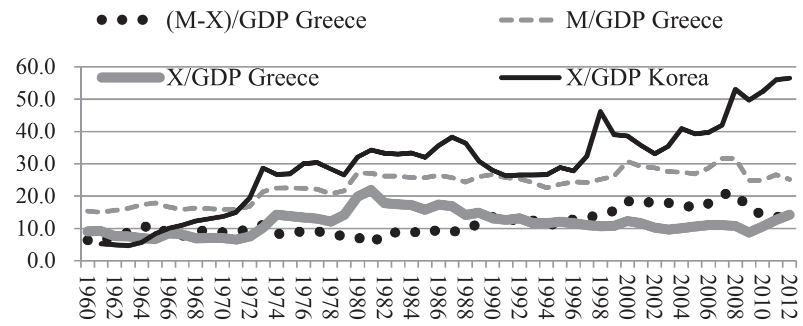
it was capable of reducing its budgets. But after having entered the Eurozone, the feast of unwise spending started again.

An immediate consequence of these budget deficits is the substantial increase in the ratio of government expenditure over GDP. In <Figure 6> we can easily see the contrast between the efficient Korean government and the Greek anti-paradigm. Again we can see the huge increases since 1981 in Greece.

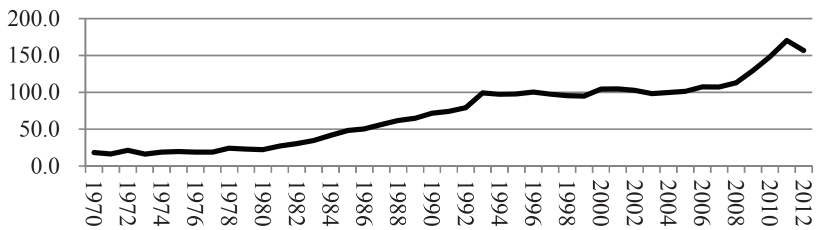
In addition, as predicted by our scenarios, the investment over GDP ratio (see <Figure 7>) started declining after 1981in Greece; and it remained at very low levels thus generating low GDP growth. On the contrary, the Korean investment ratio was kept at very high levels.

The consequence of everything we said so far is that from 1981, GDP growth crashed down to virtually stagnation (see <Figure 8>); and yet until the 1970s, Greece was considered one of the economic miracles of the world. Contrasting this with Korea, the difference is self-explanatory.

Another consequence of the mismanagement of the Greek economy is the deplorable



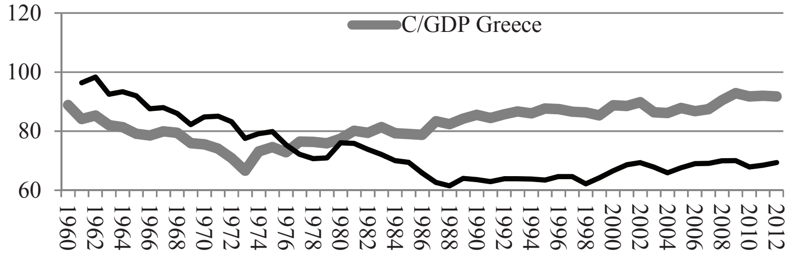

**<Figure 9>** GDP real growth in Greece and Korea (in %)




**<Figure 10>** Ratio of public debt over GDP in Greece (as %)

situation in foreign trade. As most of the budget deficit was spent on consumption and as prices (wages and CPI) were double digit; and as local manufacturing was stagnant; and as the standard of living was artificially (via lending) rising, imports were the means by which increasing consumption was satisfied in order to acquire goods generally not produced in Greece, such as cars and electronic goods. On the other hand, exports as % of GDP declined to very low levels. Greece completely "killed" its exports with its overall policies. Korea on the contrary primarily aimed at increasing exports (see <Figure 9>).

Furthermore, in Greece, a direct consequence of the huge budget deficits for many years was at the end a huge public foreign debt: about 180% of GDP (see <Figure 10>). In contrast, In Korea this ratio is about 35%. Such a huge increase of the public debt in Greece during the 2008-2013 period was the main cause of Greece not being able to borrow anymore from the free markets and hence forced this country to follow strict austerity measures as imposed by its international lenders.




**<Figure 11>** Government over GDP ratio in Greece and Korea (as %)

Another serious consequence is the government expenditure over GDP ratio in Greece which is one of the highest in the world. On the contrary, the Korean ratio is one of the lowest in the world (see <Figure 11>).

## 3. Brief discussion

The situation described so far was further undermined by the country's participation in the Euro zone for mainly two reasons. First, this participation allowed easier and increasing borrowing in European financial markets. Second, Greece was entangled in the laws of the optimum currency area model_which suggests that under fixed exchange rates or under a common currency, a country not being able to devalue its national currency in order to correct economic imbalances should instead devalue internally in terms of wages and prices in general; and the other way round, that is, a country not being able to revalue its national currency in order to correct economic imbalances should instead revalue internally in terms of wages and prices in general. Greece belongs to the first case; hence it should devalue internally in order to offset the mismanagement of its economy; and countries like Germany belong to the second case; hence they should revalue internally in order to offset their strong economic growth. The Greek internal devaluation has being taking place since 2009; hence a substantial drop in wages and salaries of about 35% occurred during 2009 to date (and even inflation rates became negative recently). On the contrary, Germany's wages and prices have remained almost constant in the past 15 years [Malliaropulos (2010)] contrary to the optimum currency area model. Germany's inertia in this respect makes it more difficult for Greece to get out of the crisis speedily and more efficiently, [Stockhammer and Onaran (2012); De Grauwe (2012)]. In contrast, Korea never faced such problem, since it devalued its own currency whenever it deemed it necessary (for example, during the Asian financial crisis of 1997/98, the Won was devalued by about 50%).

All this begs the question as to why successive Greek governments till recently have not taken any measures to change their wrong policies. Due to path dependence the civil war that apparently ended in 1949/1950 continued within the state structures and institutions. Thus, the civil or public servants in Greece have been the arena of customer relations between members of parliament and them regarding preference of parties, policies and favors. Ideologies are exploited in Greece. The median voter (as per public choice theory) has been manipulated to fit "rightist" or "leftist", or "communist", or "to the center" "ideologies" promoted by mass media and other oligarchies of power such as parties and workers unions and other lobbies of the Greek society. This was a new civil war with party members and party voters dictating economic policies to the detriment of healthy economic development. In a more specialized jargon, Greece has been a typical case of "a political manipulation of the economy" [Wagner (1977); Roberts and Legg (1991); Kiefer (2000)], and hence government expenditures were used not for achieving economic development but for political survival

Furthermore, the science of economics is completely ignored in Greece for practical purposes. The economists are called technocrats in a derogatory manner; nobody knows exactly what "economics" means in this country. The term for an economist in Greek is "oikonomologos" which practically means nothing and everything: it can mean economist, accountant, financer, banker, *etc.* There is no used special word for "finance"; *etc.* (although theoretically it exists in the rich Greek language). Of course in university circles, the situation is different; for example, in Yanitsis's edited book (2008) several notable Greek scholars have pinpointed at the problems of and solutions for the Greek economy; see also Alogoskoufis (1994), Bitros (2012), and Kollintzas (2000). However, politicians do not listen to academic economists [Bitros (2012)]. Overall, the inexistence of the appropriate wisdom of economics [Michaelides *et al.* (2013)] has been re-enforced by *the* clientele relationship between voters and parties; and by the tendency to see everything through the lens of "ideologies" ("leftist", "capitalist", *etc*.). On the contrary, South Korea remained rather "neutral" in terms of ideological battles, probably because of historical necessity (force of economics oriented dictatorships, threat of North Korea, and so on).

## 4. Conclusion

Greece now is predicted to show a positive GDP rate of growth again in 2014/2015, after several years of negative growth rates. However, the recent severe recession in this country cannot be characterized as a financial crisis. It is the consequence of about 30 years of mismanagement of its economy as explained in the text. In brief, Greece has been a typical case of a political manipulation of the economy with disastrous consequences. Some points of contrast with the Korean economy have showed that Greece did everything it could to arrive at the brink of collapse recently. On the contrary, Korea did everything to bring the nation in the top 12 most developed countries in the world.

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