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Market and Political Power Interactions in Greece: A Theory

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Abstract: In this paper, we develop a neoclassical growth model of market and political power interactions that captures the main features of the economic and political system of Greece and explains the weak economic growth of Greece in the last forty years. The model incorporates the insiders-outsiders labor market structure and the concept of an elite government. Outsiders form a group of workers that supply labor to a competitive private sector. And, insiders form a group of workers that enjoy market power in supplying labor to the public sector and influence the policy decisions of government, including those that affect the development and maintenance of public sector infrastructures. This leads to labor misallocation and inefficient fiscal policies. Thus, even though expanding public sector output has a positive effect on growth, eventually this is counterbalanced by the labor misallocation and inefficient tax policy outcomes leading to a growth reversal phenomenon. The model proposed in this paper may be applicable to other countries that have a similar politicoeconomic structure with Greece, namely other Southern European countries.

JEL classification: P16; O43; J45; O52
Keywords: Insiders - Outsiders; Politicoeconomic Equilibrium; Taxation; Fiscal Policy; Growth; Greek Crisis

"Too many politicians and economists blame austerity – urged by Greece's creditors – for the collapse of the Greek economy. But the data show neither marked austerity by historical standards nor government cutbacks severe enough to explain the huge job losses. What the data do show are economic ills rooted in the values and beliefs of Greek society. Greece's public sector is rife with clientelism (to gain votes) and cronyism (to gain favors) – far more so than in other parts of Europe".
Edmund S. Phelps, 2006 Nobel laureate in Economics, Project Syndicate, September 4, 2015. Link: http://www.project-syndicate.org/columnist/edmund-s--phelps

1. INTRODUCTION

Plotted in Figures 1a and 1b, respectively, are the real per capita GDP and its smooth trend component, in Greece and the OECD average, since 1970.[1] As shown in Figure 1a, the recession that plagued recently most OECD countries, was deeper and more protracted, in Greece, evolving to

[1] See Data Appendix for data sources and methods as well as references on the dismal growth performance of Greece and the recent Greek crisis.