Plus ça change, plus c'est la même chose

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Events during the summer of 2015 bore an air of *déjà vu*. The initial distance between Greece and its partners was significant. The frequency of meetings increased as time (and cash) ran out, with little to show in terms of progress. The discussions were held at an increasingly higher political level, but the core of the discussions remained of a "technical nature". At its climax, the Greek Prime Minister held a referendum whose two questions were incomprehensible for citizens. Then, the Greek government operated a complete U-turn, signing the Third Memorandum of Understanding (MoU) containing harsh(er) conditions.

The unfolding of events resembled the drama surrounding previous reviews of the second MoU, when the Troika would spend endless weeks in Athens prior to the disbursement of a tranche. Apart from theatrical grandstanding unusual for EU summitry, the difference with previous episodes lies in the stakes. This time round, the cost of the stand-off has amounted to full GDP percentage points. In addition, supranational institutions and actors involved in the management of the crisis have been weakened; the same applies to Member States.

The design of the third bail-out also bears a close resemblance to its predecessors. There has been a dearth of innovative ideas in policy circles, despite mounting evidence that a change of direction would be highly desirable. The perceived solution consists of front loaded fiscal adjustment and "structural reforms", with the latter being equated to the adoption of laws. The contemplated reforms are "ambitious" and the timetable even more so. As was to be expected, Greece plunged back into recession, putting further doubts on the country's ability to service its debt. Growth prospects remain elusive.

Beyond altering expectations, structural reforms do not generate short term growth per se. What they do, when properly designed, is to create the conditions for putting growth on a sustainable path. Sustainability must be understood in a broad sense, going beyond fiscal aggregates and encompassing social and environmental sustainability. In the medium term, growth, to be sustainable, requires continuous productivity improvements. Without them, growth is an optical illusion that usually ends up in tears. It is quite telling that the first and second MoU only mention productivity in the context of market liberalization; the third MoU does not mention it even once.

"Structural reforms" have been both deep and insufficient. The "horizontal measures" (tax increases, pension and wage cuts) have been unprecedented for a European country. At the same time, too little progress has been achieved regarding genuine structural reforms, i.e. reforms that change the way the economy functions, adjusts and grows.

By now, we know (or at least we should know) that it takes time to design and implement genuine reforms. The costs are typically front loaded, while the benefits take time to materialise, are diffuse, and hard to quantify. In Greece, they have to be implemented in an extremely adverse environment.

"Reforms" have often been half-baked, regularly ending with rushed through legislative adoption as “Prior Actions” without proper follow-up, often due to limited resources. The lack of tangible benefits stemming from reforms has convinced a growing proportion of the population and civil servants that "reforms" are not well designed and/or might not lead anywhere, i.e. not worth pursuing. Reform fatigue has set in.

Even before crisis, the Greek civil service was known for its unwieldiness and structural weaknesses. By now, it is demoralised and weaker, as many of its more competent staff left. Public servants enjoy very little effective autonomy, as they fear harsh punishment if they displease their political masters. This leads to administrative formalism and inactivity. Yet, it is this weakened civil service that is supposed to design and implement structural reforms.

The third MoU rightly emphasizes the need for Greek ownership of the adjustment programme. This is quite a challenge, as the programme is perceived as the imposition by foreigners of extremely harsh conditions. Parts of the current government have openly stated their dislike of any reform related to the programme (Minister Spirtzis publicly lamented that he had to sign off the privatization of regional airports).

Programme implementation is a “Principal-Agent” problem. The “Principal” (the decision maker) is made-up of creditors and the Troika and the “Agent” (the implementer) consists of the Greek government and public administration. The respective objective functions and associated incentives of the two parties differ significantly. The Principal cannot implement directly and suffers from information asymmetry (the drafting of detailed requirements in the second MoU has often resulted in revealing to the Greek authorities the extent to which the Troika did not have the full picture). In short, the creditors/Troika want something to happen and have to rely on Greek authorities to make it happen. Difficulties arise when the incentives are too misaligned. To a large extent, the limited success of the previous programmes derives from the lack of incentive compatibility. “Greek ownership” is basically an issue of aligning incentives.

Determining who the “Principal” is and how it set priorities is an interesting question, given the diversity of actors involved (the three components of the Troika, the

EuroGroup that decides but delegates implementation to the Troika, Member States, the European Council, and the EU Commission beyond its participation in the Troika). Multiplicity of interlocutors has added a layer of complexity to a challenging situation.

There is no panacea to the Greek drama, but a route that would have been worth exploring is to identify reform areas that are "win-win" and that could deliver positive results over a relatively short time span. That could contribute to alleviate reform fatigue and show that well designed reforms are worth implementing. To be "win-win", a reform must be to the liking of the Principal and yield a net benefit for the Agent. In practice, the latter implies focusing on projects that involve few, if any, costs to local constituencies or vested interests. If these conditions are met, implementation could be closer to incentive compatibility.

Such reforms exist, but have been partially (and often reluctantly) implemented, or not at all. I limit myself to mention three of them: the introduction of a well targeted Guaranteed Minimum Income (GMI), the development of a fully fledged export strategy, and cost effective, incentive compatible ways to close the VAT gap in the form of a Portugal like "VAT lottery".

Greece lacks a proper targeting mechanism to identify the people and households that are most in need. The second MoU included a clause to finance a GMI pilot; the envisaged cost for the pilot was limited (about 20 million). The returns to designing a successful pilot programme are high as it would allow for a proper targeting of limited resources to the benefit people living in deprivation. It would also relieve the pressure on other policy tools (e.g. pensions) to play the role of a social safety net. Despite the support provided by the EU via the Task Force for Greece (TFGR), the project had a slow start, with Greek authorities starting collaboration with the World Bank in October 2013. The relevant legislation to launch the pilot was adopted in November 2014. Despite numerous difficulties and teething problems, the pilot was launched in 13 municipalities and appeared to fulfil the objectives underpinning a GMI.[1] The January 25, 2015 general elections led to a freeze of the GMI project; the objective was to replace it with in-kind support contemplated in the "Humanitarian Crisis Law". However, it seems that, following pressure from Greece's creditors, the GMI project has been revived, with national implementation now envisaged for 2017. Time will tell whether the poorest will one day benefit from the protection offered by a social safety

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[1] http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2015/06/29/090224b082fa1eaa/1_0/Rendered/PDF/Ex0ante0povert00programme0in0Greece.pdf
http://ec.europa.eu/economy_finance/assistance_eu_ms/greek_loan_facility/pdf/assessment_social_impact_en.pdf
http://www.basicincome.org/news/2015/08/greece-government-to-roll-out-a-guaranteed-minimum-income-scheme/

net. One can only wonder why this has not been more of a priority for all the actors involved.

Despite generous financing conditions, Greece's is crumbling under its external debt burden. (Part of) that debt will only be repaid if Greece's grows and is able to generate a current account surplus. In addition to shipping income and tourism, exports of goods and services should contribute to that objective. With the support of the United Nations Economic Commission for Europe (UNECE) and the EU Commission, Greek authorities drew up an ambitious roadmap to strengthen the country's export potential by cutting red-tape.[2] This "trade facilitation" exercise was part of a broader strategy that included efforts to develop Greece's export base and to embark on a "trade promotion efforts" by developing inter-ministerial coordination and economic diplomacy. Some progress was achieved in simplifying customs procedures; this resulted from a combined push by the Troika shouldered by EU technical support provided by the Task Force for Greece (TFGR) and reform minded elements in the Greek administration. This favourable constellation did not materialise for the development of the other pillars of the strategy to turn Greece into an export oriented economy. As a result, little, if anything, was achieved. By and large, the administrative and institutional environment to support trade has remained unchanged. In view of the type of external adjustment that Greece's requires, it is surprising that outward orientation did not rank higher on the reform agenda.

VAT is government's single most important source of revenue. From 2000 to 2012 it amounted, on average, to 7.15% of GDP and the total amount collected in 2012 alone was €13.7billion, higher than any other source of tax revenue. Despite its significance, a large portion of VAT remains uncollected each year. The European Commission has estimated that the VAT gap (the difference between receipts that should accrue to the State and actual ones) every year has risen close to 10b euros in recent years, equivalent to 4.7% of GDP. Over the period 2001-2011 the deterioration in VAT tax compliance amounted to about 5 billion € of lost revenue for the Greek State. So far, the Greek government has largely tried to increase total tax revenue through additional measures, either through increases in tax rates (for VAT and excise duties) or the introduction of new taxes. It is by now commonly accepted that that this recipe has reached its limits. Only measures that will broaden the tax base, increase the efficiency of the tax administration and most importantly, improve overall tax compliance, can help to meet the challenge of increased tax revenues.

In that context, a Greek researcher (Dr. Georgiou) based in a public research center (Demokritos) has developed (and patented) a simple technology (christened

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https://www.unece.org/fileadmin/DAM/trade/GreeceTradeFacilitationReforms/Documents/NationalTradeFacilitationStrategyRoadmap.pdf

“@podeixi”) to boost VAT collection.[3] The underlying idea of this scheme is very straightforward. When purchasing goods and services, each customer should receive a receipt. Each receipt is required to contain some basic information, such as time of purchase, the amount of paid and the trader’s tax identification number. This basic information can easily be sent with a mobile phone or the web, using a predetermined format to a dedicated database. This receipt-specific information would then be encoded, without any further human intervention. A secured server would then run random draws at specified time intervals and submitters of these receipts would win lottery prizes.

Such schemes have been in place -sometimes already for decades- in countries such as Taiwan, mainland China and South Korea. Specifically, Taiwan launched such a system in 1951 as it desperately needed to boost revenues. In view of its success, the scheme is still in force today. The Peoples' Republic of China introduced a pilot scheme in 1998 and proceeded with national roll-out in 2010. The Chinese version of the scheme has been shown to generate an increase in VAT revenue of about 17% (Wan 2010).[4] There are three Eurozone countries where similar schemes are running; Malta, Slovakia and Portugal. In all three cases, the experience has been successful.[5] Fundamentally, these schemes have worked because they are incentive compatible and hence do not to rely on coercion and control mechanisms.

One of the most appealing features of ‘@podeixi’ is that it does not rely on a heavy up-front investment in infrastructure such as new cash machines that are directly connected to the tax administration, but on readily available technology which could be run at rather low administrative cost. This scheme could easily be tested on a pilot basis at short notice, thus minimising the risks for the public purse. It has been estimated that a pilot (including hardware, promotion, and prizes) could be a carried out for less than 1.8 million €. Its limited costs means that the balance of risks is favourable (limited downside, enormous upside if successful). Again, the option of pursuing the cost effective pilot has not pursued. Instead it would appear that promotion of e-money is perceived as a panacea for reducing tax evasion. One wonders where such high hopes have any empirical or analytical foundations.

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[3] Georgiou, V, "A high tech approach to tax compliance with probabilistic cash incentives", (in Greek), available at: http://users.iit.demokritos.gr/~vgeorgiou/index.html
NCSR Demokritos and V. Georgiou, “Electronic System for the Management of Tax Receipts” Greek Patent 1007355, Jan 15, 2010.

[4] Wan, J., “The Incentive to Declare Taxes and tax Revenue: The Lottery Receipt Experiment in China”, Review of Development Economics, Volume 14, Issue 3, pages 611–624, August 2010.

[5] For instance, the Portuguese Tax Authority estimates that VAT revenue have increased by €800m in the first half of the year (statement by Secretary of State for Fiscal Affairs, Paulo Nuncio on June 26 2014). The increase is attributed to the success of the system, as no other VAT reform has been introduced at the same period whilst the quarter-on-quarter GDP has contracted by 0.6% in the first quarter of 2014. In addition, there were 67000 more firms registering receipts in the first 6 months of the year compared to last year, indicating a move from the shadow economy to the formal economy.

Three final remarks. Overambitious reforms and deadlines lack credibility and hence are not incentive compatible. In the best of cases, they produce short term patches. Second, in order to achieve incentive compatibility at the micro level, civil servants who contribute to the design of genuine reforms and participate in their implementation should be rewarded for their efforts. Third, in view of Greece's weak administrative capability and the nature of the challenges, reform projects should be implemented on a pilot basis whenever feasible. Pilots are a cost effective way to carry a "proof of concept" for a particular reform, avoiding large scale costly errors. The experience with the embryonic GMI project bears this out.