

Grecovery? A Question of Trust

Elias Papaioannou

London Business School (Economics) & CEPR

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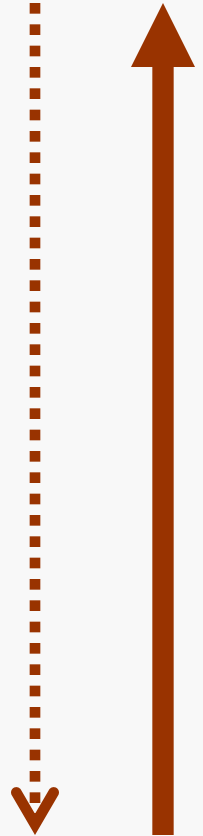
Athens, 7 May 2019

From *GRexit* to *GRcovery*

—Why?

—What next?

Crisis Facets



Outline

Why? GRexit

- **Economic** [Fiscal, Financial, Competitiveness]
- **Institutional** [public administration, judiciary, regulation product, labor and capital markets, corruption]

Why? The Missing Element. Civic/Social Capital and Trust

- **Norms, Beliefs, Trust**

What next? GRecovery

- **A Question of Trust**

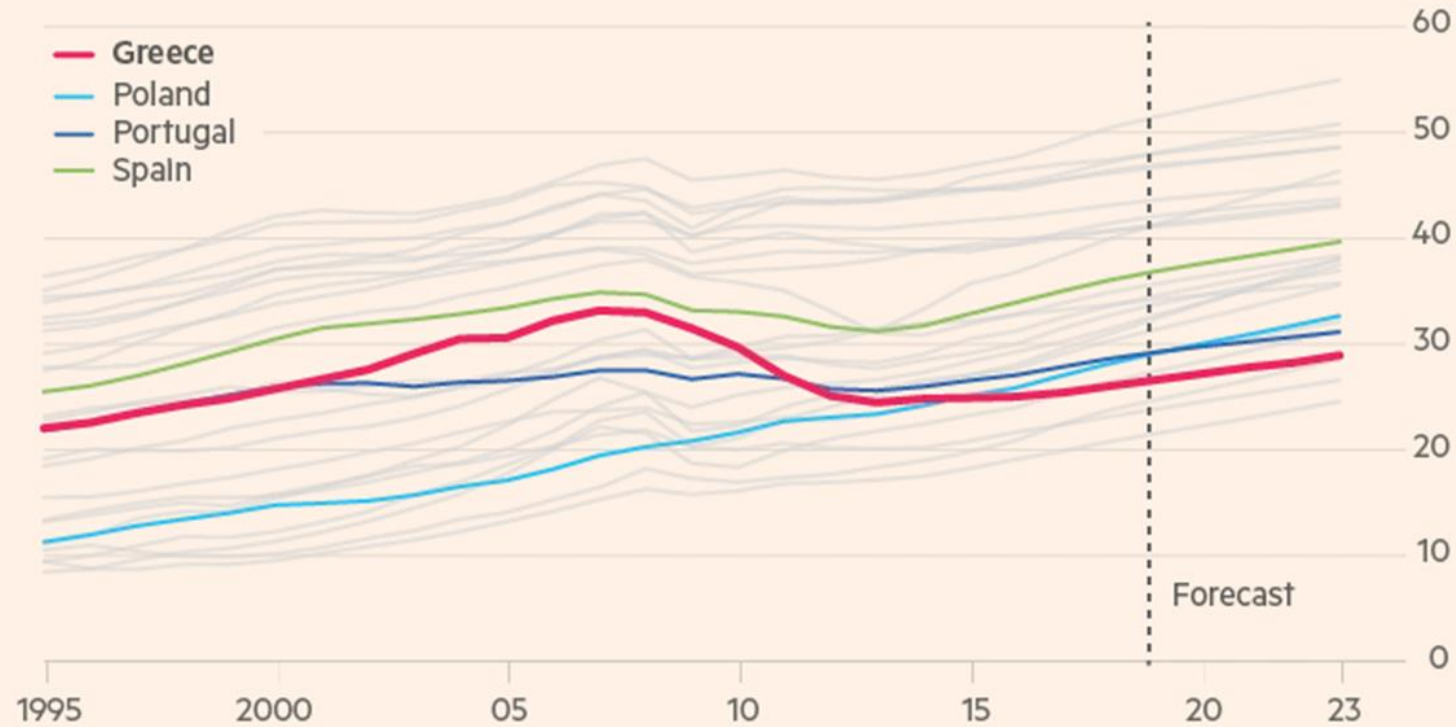
The Crisis. The Stats

- **Output (GDP p.c.).** -25%
- **Unemployment:** from around 10% to 20% (peak of 27%). Among youth: ~50%
 - Declining labor force participation
 - Exodus of Greeks
- **Investment.**
 - Peak 25,9% (2008) to 13.3% (2017); around 10% in crisis years;
 - €65 billion -> €25billion
- **Property prices:** drop 42%
- **Greek bank's NPLs.** Close to 100bn (50% GDP)
- **Extreme poverty: from around 7% to 15%**
 - single member household in Athens with rent or mortgage with less <€ 395;
family of four with rent or mortgage in Athens < € 900)

The Crisis. In a Nutshell.

Greece is now the fourth poorest EU country

GDP per capita at 2011 purchasing power parity (\$'000)



Source: IMF
© FT

Why? **Still unanswered...**

- **Lack of consensus**
 - Even on the data....
- **Political animosity**
- **Social animosity**
- **Inequality**
- **Noise (from media, politicians)**
- **Distorted beliefs**

The Blame Game

- Banks
- Labor Unions
- The “Elite”
- Politicians [old, new]
- Political Parties [old, new]
- Administration-bureaucracy
- Regulators
- Media (and journalists)
- The euro and EMU architecture

- The Troika [EU, ECB, IMF]



Crisis Readings. **Economics**

1. **Fiscal Profligacy.** *Punitive View.*

- Public debt & fiscal deficits during booming years (esp. 2004, 2007-2009)
- Private consumption

2. **Fiscal Policy during the crisis.** *NK-economists View*

- “aggregate fiscal multiplier”; fiscal devaluations
- Troika’s role [obsession with austerity]

3. **Doom Loop between Banks & Sovereigns.** *Macro-Finance View*

- Non-Performing Loans [NPLs]
- deposit withdrawals, capital controls, regulation-supervision

4. **Competitiveness.** *International Macro and Growth Economists View*

- Trade (current account) imbalance (exports-imports); wage inflation
- Efficiency; private sector (profitability, management, corp. governance)

Let's Abstract. Macro Lessons

1. Business Cycle Literature

- Monetary & Fiscal Policy -> Stabilization Tools
- Small (if any) long-run effects

2. Growth Literature

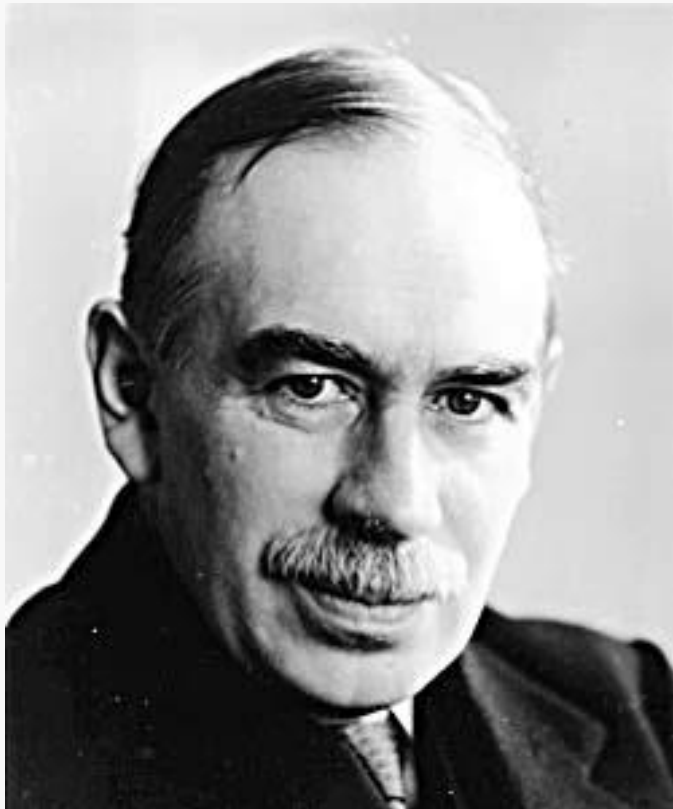
- Physical capital -> around 20%-30% variation in economic performance
- labor utilization and human capital -> 40% [max 50%]

Needed.

- Expand notion of “capital”
- A theory of efficiency [Total-Factor-Productivity].
 - Deep determinants

Macro Lessons (cont.) The Devil Is in the Details.

Two Types of Debt and Deficits



John Maynard Keynes



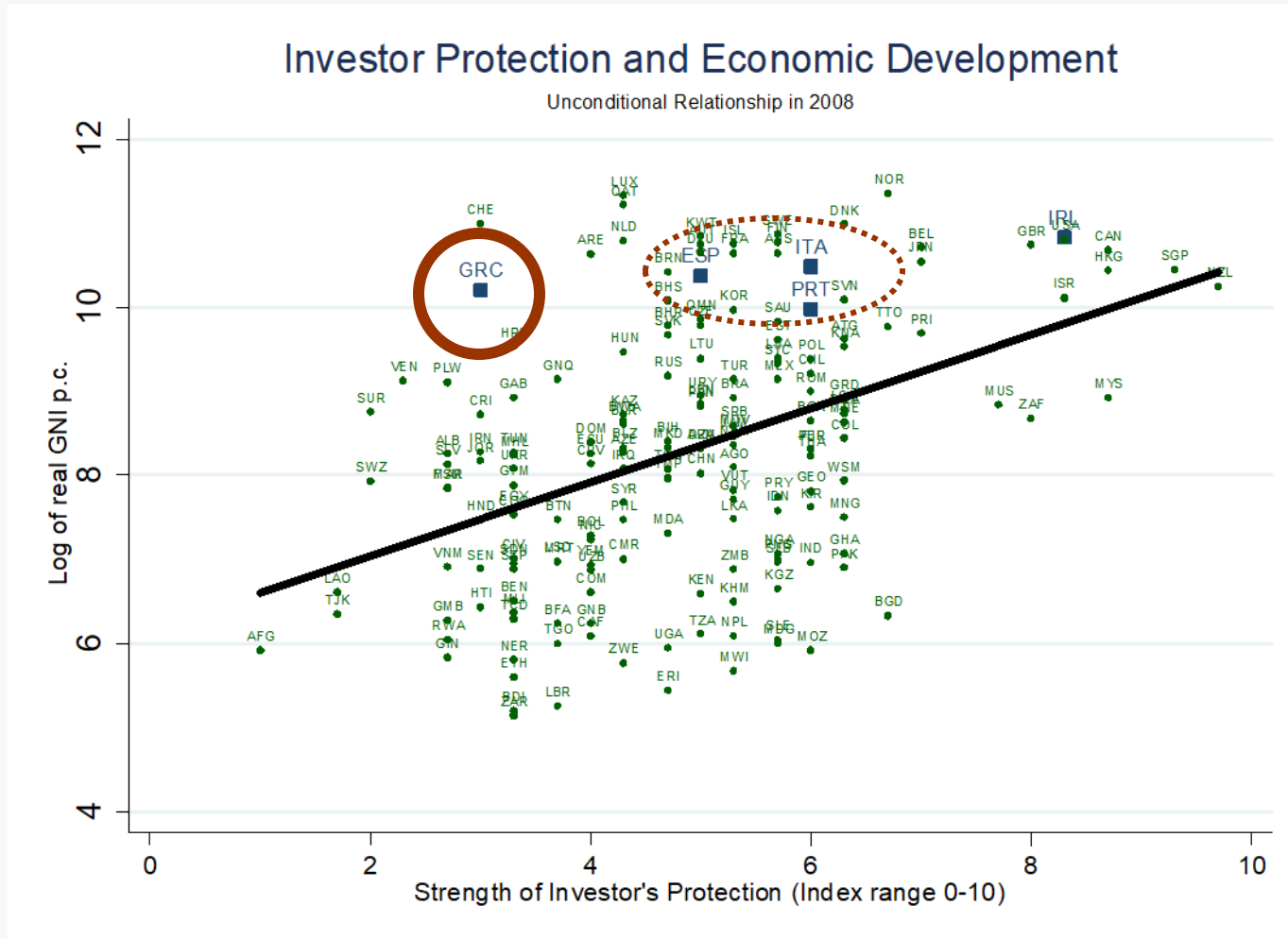
Juan and Eva Peron

Crisis Readings. **Institutional [Formal Rules of the Game]**

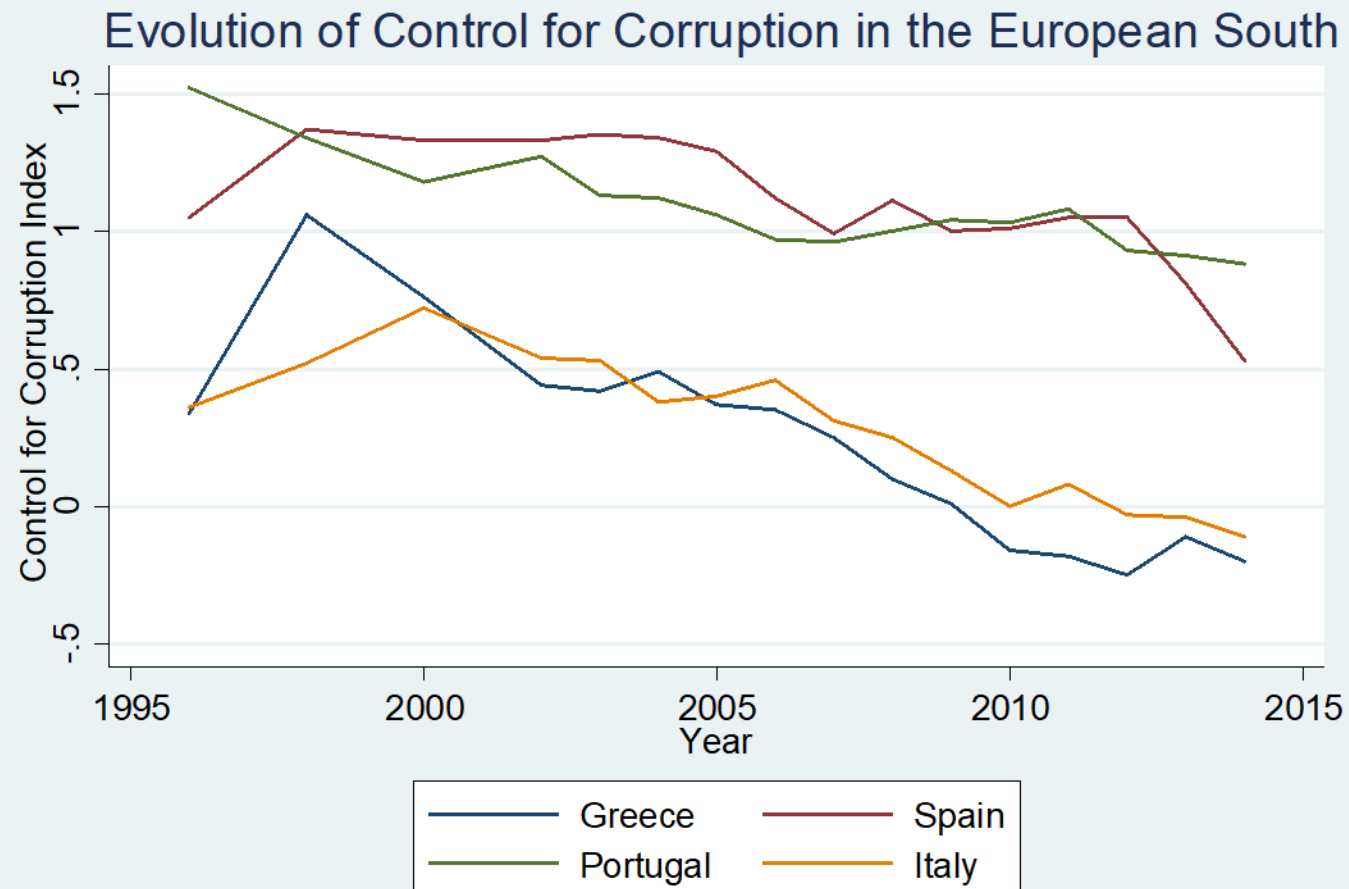
Some Institutional Aspects

- **Bureaucratic-administrative capacity** and quality
- **Property rights** protection
- **Checks and balances** on the executive
- **Courts** (time, quality, formalism) and judiciary
- Legal **protection of investors** (creditors, shareholders) from expropriation
- **Corporate governance** mechanisms (regulation, auditing)
- **Red tape** (administrative barriers to entry and firm expansion)
- Control of **corruption**

The Institutional Thesis in a Nutshell



Institutional Drift, European South



Source: World Bank Governance Matters Indicators

Institutional Gaps and Divergence across the Euro Area

- **Considerable gaps in various proxy measures of institutional efficiency**
 - Greece scores the lowest across EU 27 in a plethora of measures
 - Gap between the “core” and the “periphery” and “eastern Europe”
- **Non-negligible institutional divergence (especially after euro’s inception)**
 - Public administration (quality of bureaucracy)
 - Regulatory quality (product markets, banks, labour markets)
 - Red tape and control for corruption
 - Legal capacity, court efficiency, and legal quality
- **Also gaps in corporate governance and managerial quality/practices**
 - Not much discussion
 - Easy to blame the amorphous state

But,...

- **Institutions, policies, and economic success are outcomes**
- **Endogeneity**
- **Missing elements?**

Crisis Reading. The Missing Elements

—Civic/Social Capital

—Trust

Culture

“If we learn anything from the history of economic development, it is that culture makes almost all the difference”. [David S, Landes, 2000, p. 2]

Culture?

- **Trust** (general, within-family, outside, institutions, etc)
- **Social/civic capital** [engagement, political participation, civicness]
- **Norms and beliefs** (e.g., about success in life, role of luck, attitudes towards science, etc)
- **Religion**
- **Family ties**

Culture. Informal rules

“those customary beliefs and values that ethnic, religious, and social groups transmit fairly unchanged from generation to generation.”

[Guiso, Sapienza, and Zingales (2006)].

Culture and Institutions. Caveats

Interconnections

Culture (beliefs, norms, trust) → ← Institutions (product market regulation, legal formalism, quality of administration, red tape, etc)

Hard to distinguish

- Common historical (and other) origins
 - Role of geography, ecology, and other features
- “Formal” - “Informal”

It's a Matter of Trust

“Virtually every commercial transaction has within itself an element of trust, certainly any transaction conducted over a period of time. It can be plausibly argued that much of the economic backwardness in the world can be explained by the lack of mutual confidence.”

Kenneth Arrow (1972)

It's a Matter of Trust, cont.

“There are countries in Europe ... where the most serious impediment to conducting business concerns on a large scale, is the rarity of persons who are supposed fit to be trusted with the receipt and expenditure of large sums of money.”

John Stuart Mill (1848)

The History of an Idea. Trust and Civicness

- **The Republic (*Politia*). Plato. Civic virtue (*arete*).**
- **Worldly philosophers of the Enlightenment. John Locke, Montesquieu, John Stuart Mill**
- **Founding fathers of US Constitution (James Madison, Benjamin Franklin).**
 - A Mrs. Powel of Philadelphia asked Benjamin Franklin in 1787: “*Well, Doctor, what have we got, a republic or a monarchy?*”
 - Benjamin Franklin responded, “*A republic, if you can keep it.*”
- **Recent revival of interest (1990). Robert Putnam, Francis Fukuyama**
 - Subsequent empirical tests in various contexts

The Beginning of Wisdom is the Definition of Terms

Social Capital

- *“features of social life—networks, norms, and trust—that enable participants to act together more effectively to pursue shared objectives”*; Robert Putnam (1995)
- *“the aggregate of the actual or potential resources which are linked to possession of a durable network of more or less institutionalized relationships of mutual acquaintance and recognition”*. Pierre Bourdieu (1985)
- *“a set of relationships that support effective norms (related to beliefs and social behaviour)”*. James Coleman (1990)

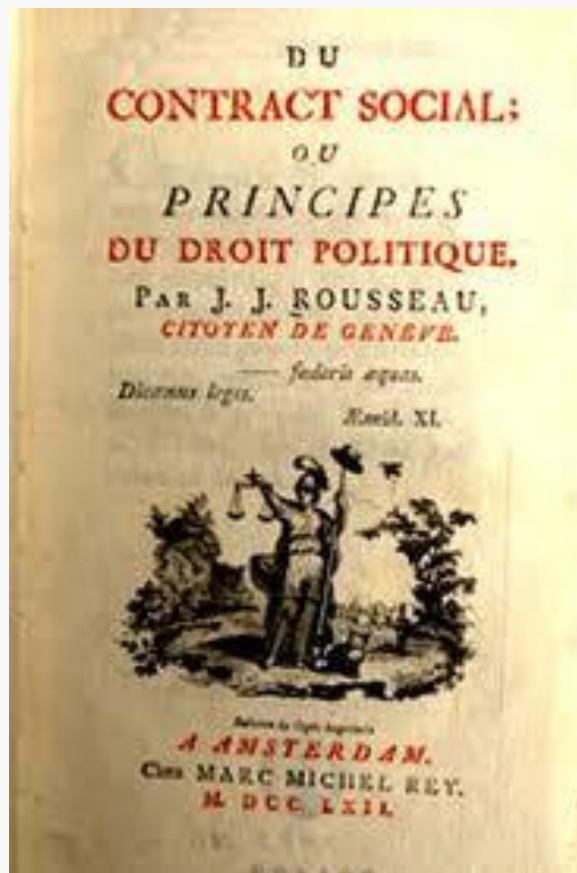
Definitions. Civic Capital

- “*a set of beliefs, attitudes, norms, perceptions and the like, that support participation.*” Almond and Verba (1963)
- “*Those persistent and shared beliefs and values that help a group overcome the free rider problem in the pursuit of socially valuable activities.*” Luigi Guiso, Paola Sapienza, and Luigi Zingales (2011)

Social/Civic Capital. Key Elements

- **Trust**
- **Participation**
- **Cooperation**
- **Inclusiveness**

Social Contract



Notes

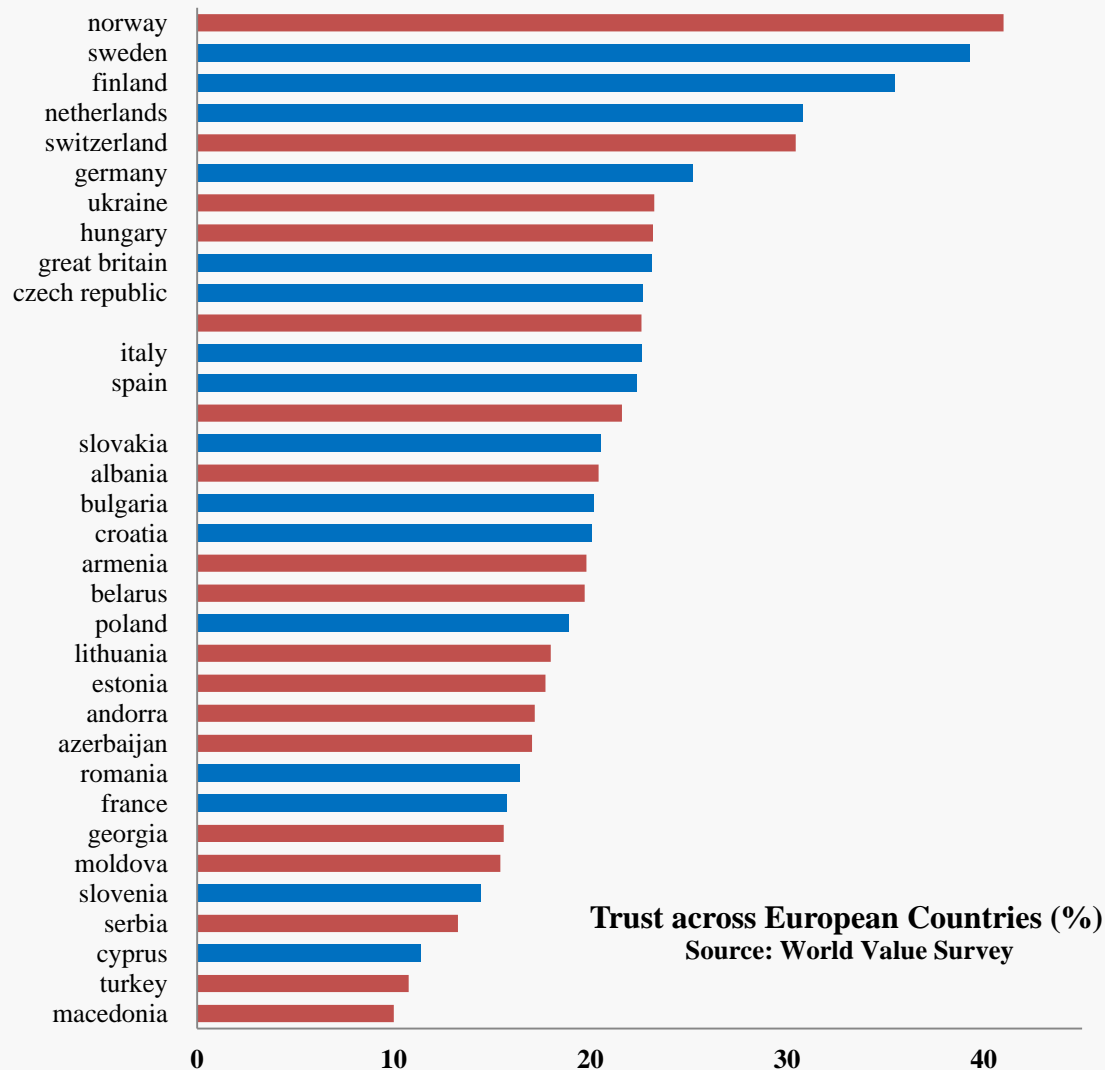
Trust, social/civic capital considerations absent from

- Standard (workhorse) economic models that are used for policy-making)
- Policy recommendations from international institutions (e.g., IMF, WB, EU Commission, etc.)
- Consulting (management)

Measurement (*Challenging*)

- **Trust (surveys, lab games)**
- **Participation in NGOs**
- **Participation in local (or general) elections**
- **Donations (philanthropy)**
- **Blood (organ) donation**
- **Littering**
- **Tax-evasion (actual and beliefs)**
- **Beliefs on social issues (e.g., gay rights, immigrants, gender roles)**
- **In-the-lab games**

Trust in Europe



WVS Question:

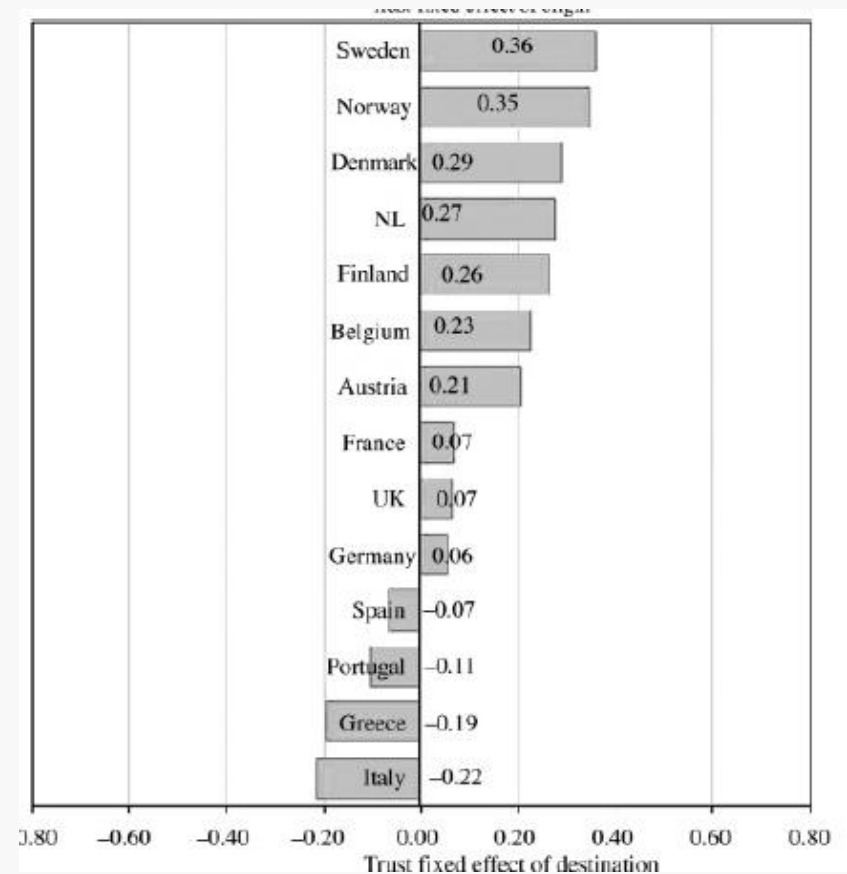
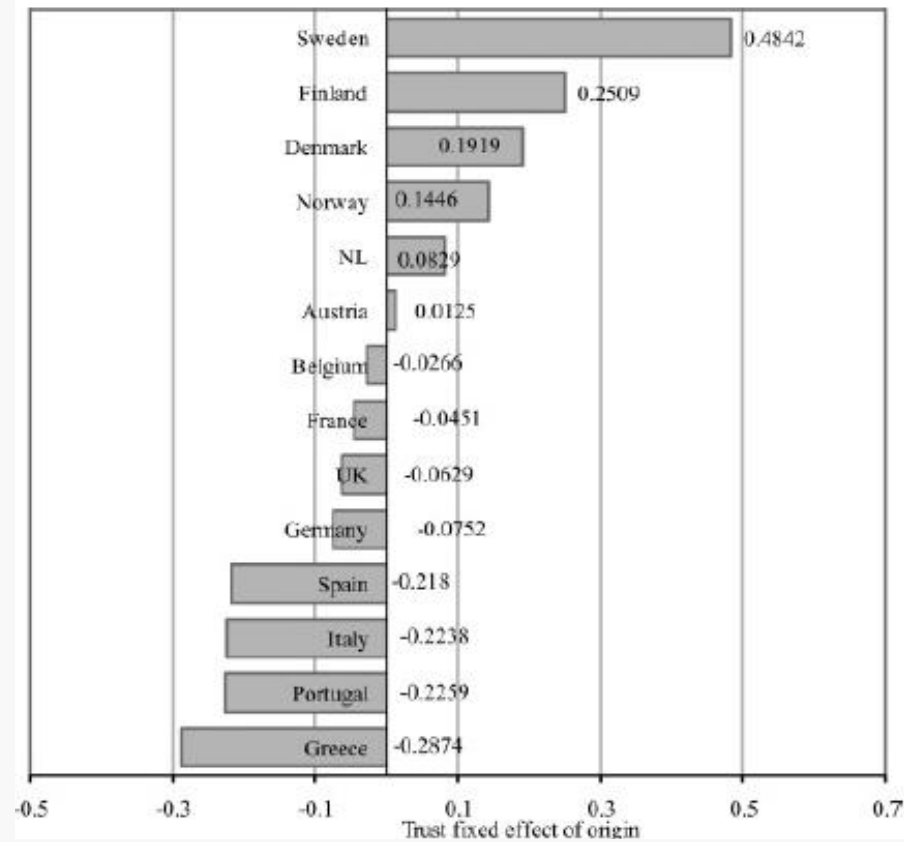
*Generally speaking, would you say
that most people can be trusted or
that you need to be very careful in
dealing with people?"*

Bilateral Trust in Europe (before the introduction of the euro)

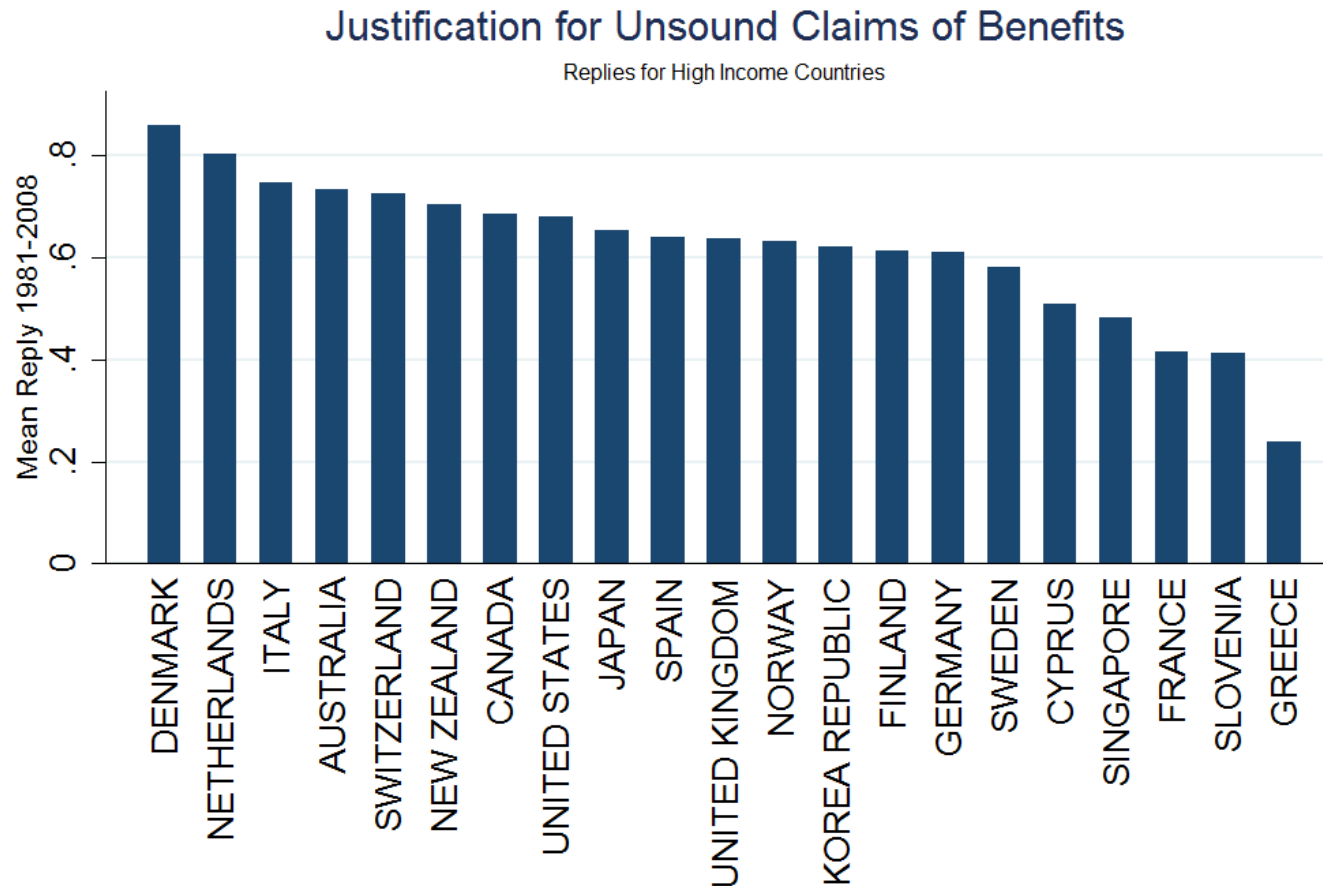
The Trust Matrix

Countries of origin:	Countries of destination:															Average
	Aus	Bel	UK	Den	NL	Fin	Fra	Ger	Gre	Ire	Ita	Nor	Por	Spa	Swe	
Austria	3.56	2.95	2.61	2.95	2.95	2.94	2.62	3.09	2.52	2.55	2.43	3.00	2.50	2.58	3.05	2.82
Belgium	2.83	3.28	2.84	3.01	2.90	2.92	2.92	2.75	2.45	2.75	2.40	2.91	2.53	2.59	2.99	2.80
United Kingdom	2.89	2.91	3.29	3.13	3.16	2.98	2.32	2.62	2.54	2.61	2.51	3.06	2.74	2.47	3.03	2.82
Denmark	3.22	3.18	3.22	3.39	3.33	3.20	2.86	3.12	2.61	3.02	2.53	3.50	2.67	2.66	3.41	3.06
Netherlands	2.90	3.18	3.00	3.29	3.28	3.25	2.72	2.84	2.59	2.80	2.35	3.30	2.74	2.64	3.34	2.95
Finland	3.29	3.07	3.18	3.30	3.14	3.69	2.92	2.89	2.68	2.92	2.51	3.48	2.67	2.61	3.35	3.05
France	2.70	3.07	2.55	2.96	2.94	2.91	3.18	2.74	2.53	2.72	2.43	2.97	2.59	2.68	2.99	2.80
Germany	2.98	2.84	2.69	2.97	2.90	2.85	2.85	3.50	2.51	2.59	2.36	2.92	2.48	2.66	2.99	2.81
Greece	2.32	2.60	2.34	2.56	2.55	2.42	2.78	2.31	3.21	2.55	2.33	2.40	2.60	2.71	2.51	2.55
Ireland	2.93	2.93	2.81	2.99	3.00	2.92	2.81	2.78	2.50	3.33	2.65	2.93	2.65	2.64	2.92	2.85
Italy	2.66	2.64	2.51	2.70	2.77	2.78	2.66	2.63	2.40	2.37	2.80	2.78	2.32	2.64	2.89	2.64
Norway	.	3.18	3.27	3.53	3.26	.	2.93	2.99	2.52	3.01	2.65	.	2.60	2.56	.	2.95
Portugal	2.13	2.66	2.66	2.66	2.70	2.18	2.91	2.54	2.41	2.51	2.55	2.22	3.29	2.59	2.24	2.55
Spain	2.65	2.73	2.31	2.73	2.85	2.71	2.37	2.66	2.47	2.57	2.61	2.79	2.51	3.32	2.84	2.67
Sweden	3.53	3.23	3.43	3.57	3.33	3.49	3.04	3.13	2.88	3.26	2.81	3.65	2.97	2.86	3.59	3.25
Average	2.90	2.96	2.85	3.05	3.00	2.95	2.79	2.84	2.59	2.77	2.53	2.99	2.66	2.68	3.01	

Bilateral Trust – Origin and Destination

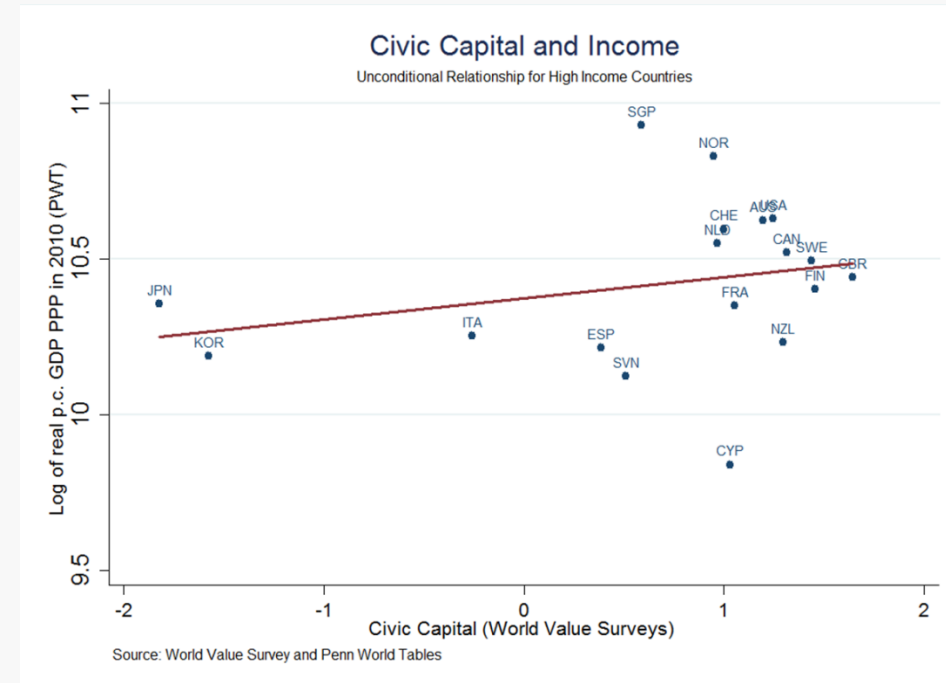
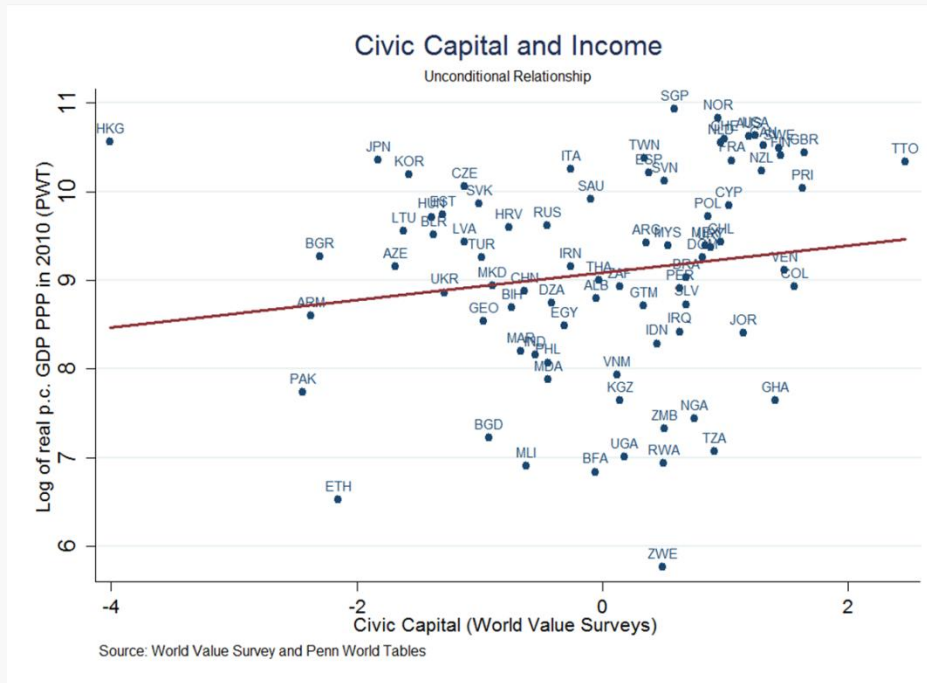


Beliefs. Justification for Unsound Claims of Benefits

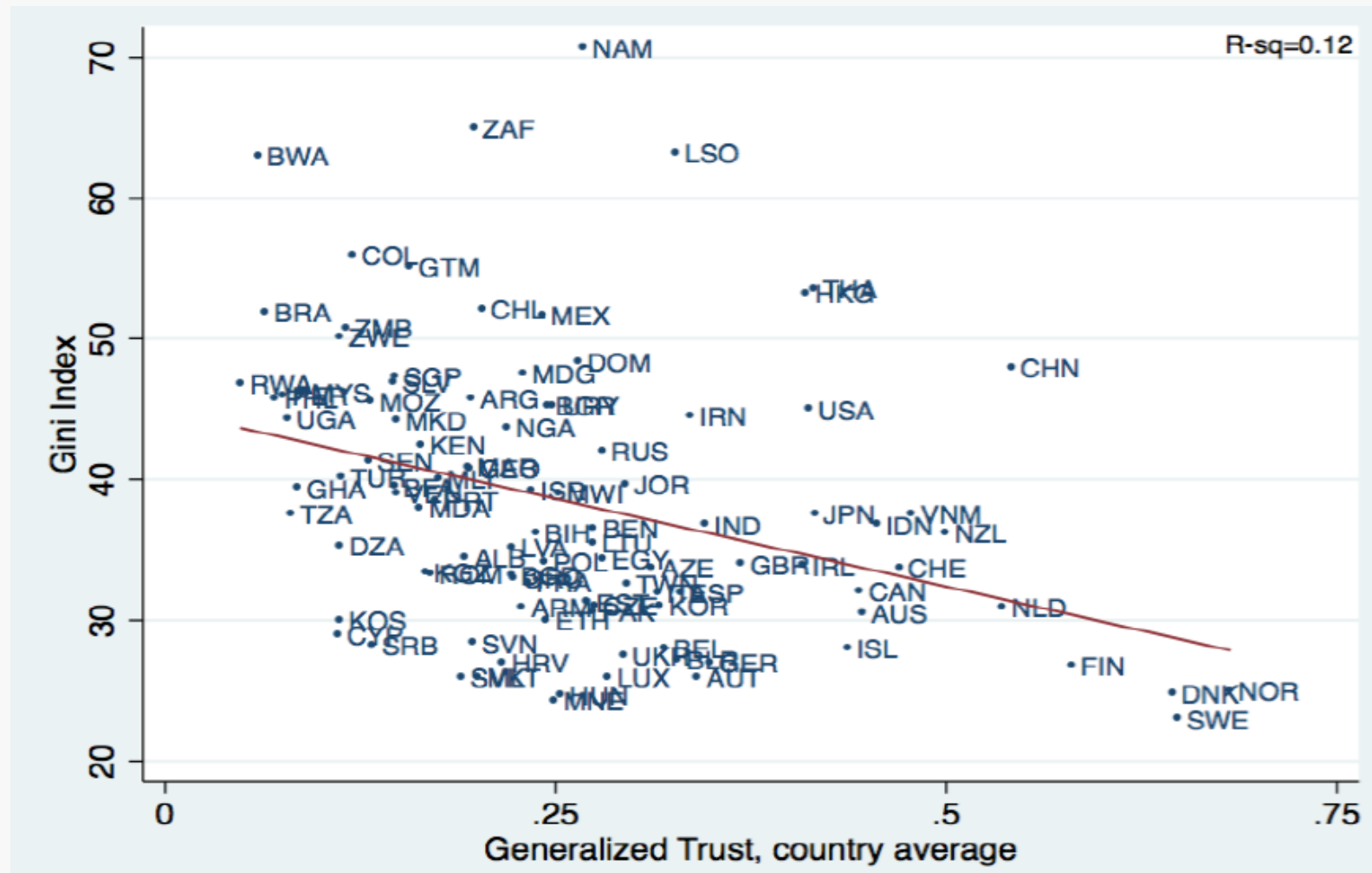


Source: World Value Survey

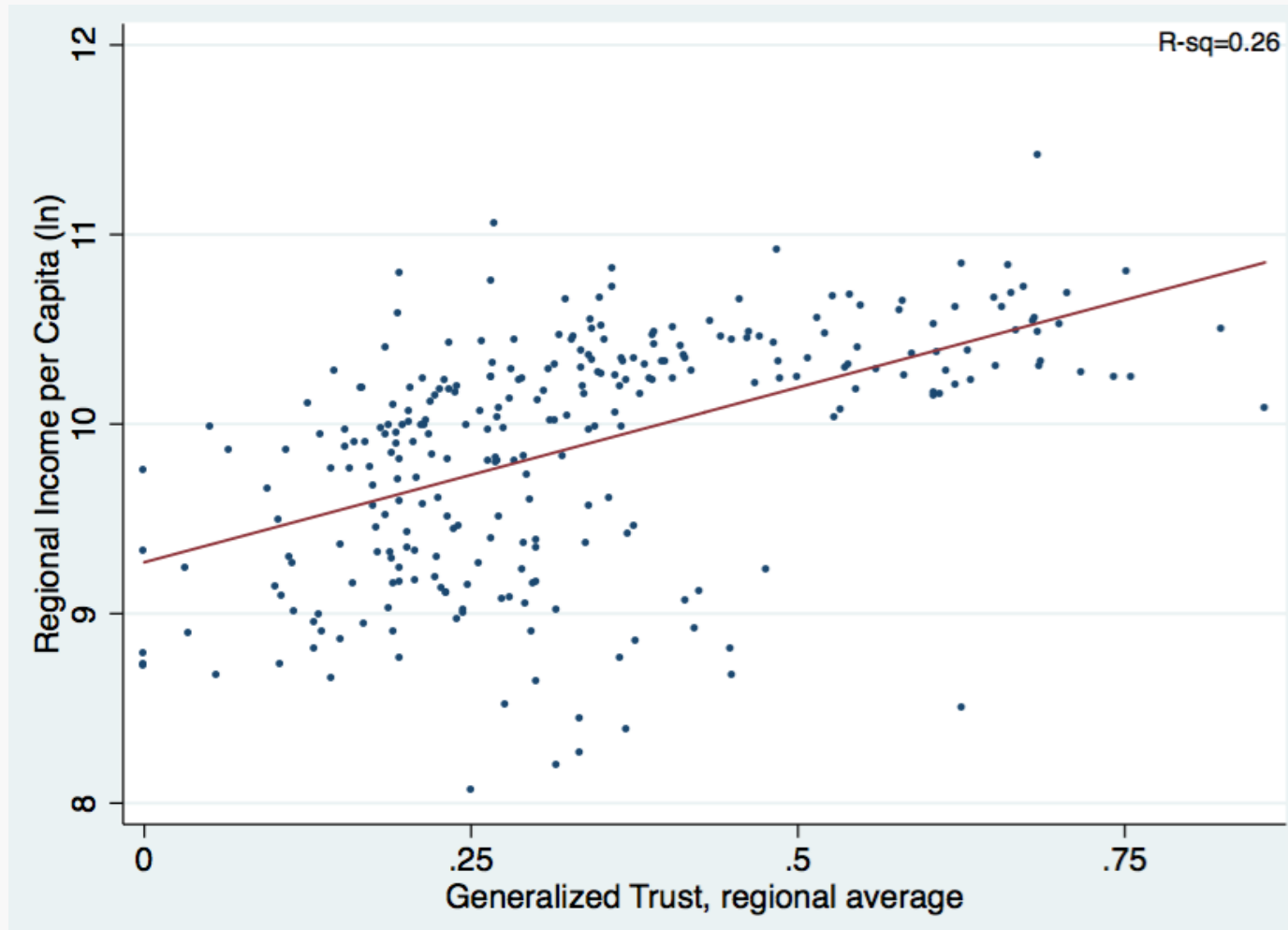
Civic Capital and Economic Performance



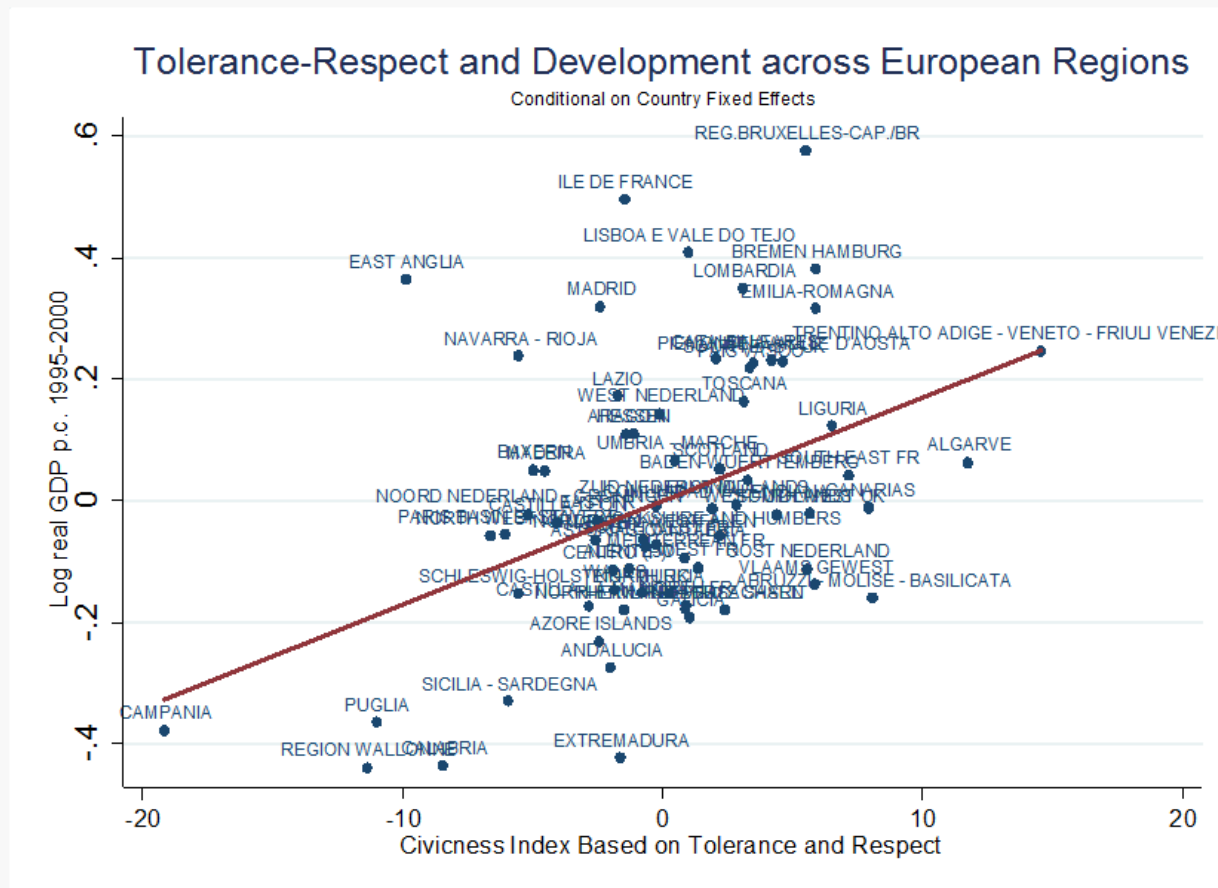
Trust and Income Inequality across Countries



Income and Trust across OECD country Regions



Tolerance-Respect and Economic Performance across European Regions (cond. on country fixed features)



Civic Capital, Trust and Economic Performance.

Mechanisms

- **Trade – commerce (openness)**
- **Investment, esp. R&D**
- **Risk Diversification (stock market participation)**
- **Credit**
- **Distrust – Red Tape and Formalism – Corruption – Distrust**
- **Welfare state policies (redistribution, inequality)**
- **Organizational structure & management quality**

A Closer Look on Some Mechanisms

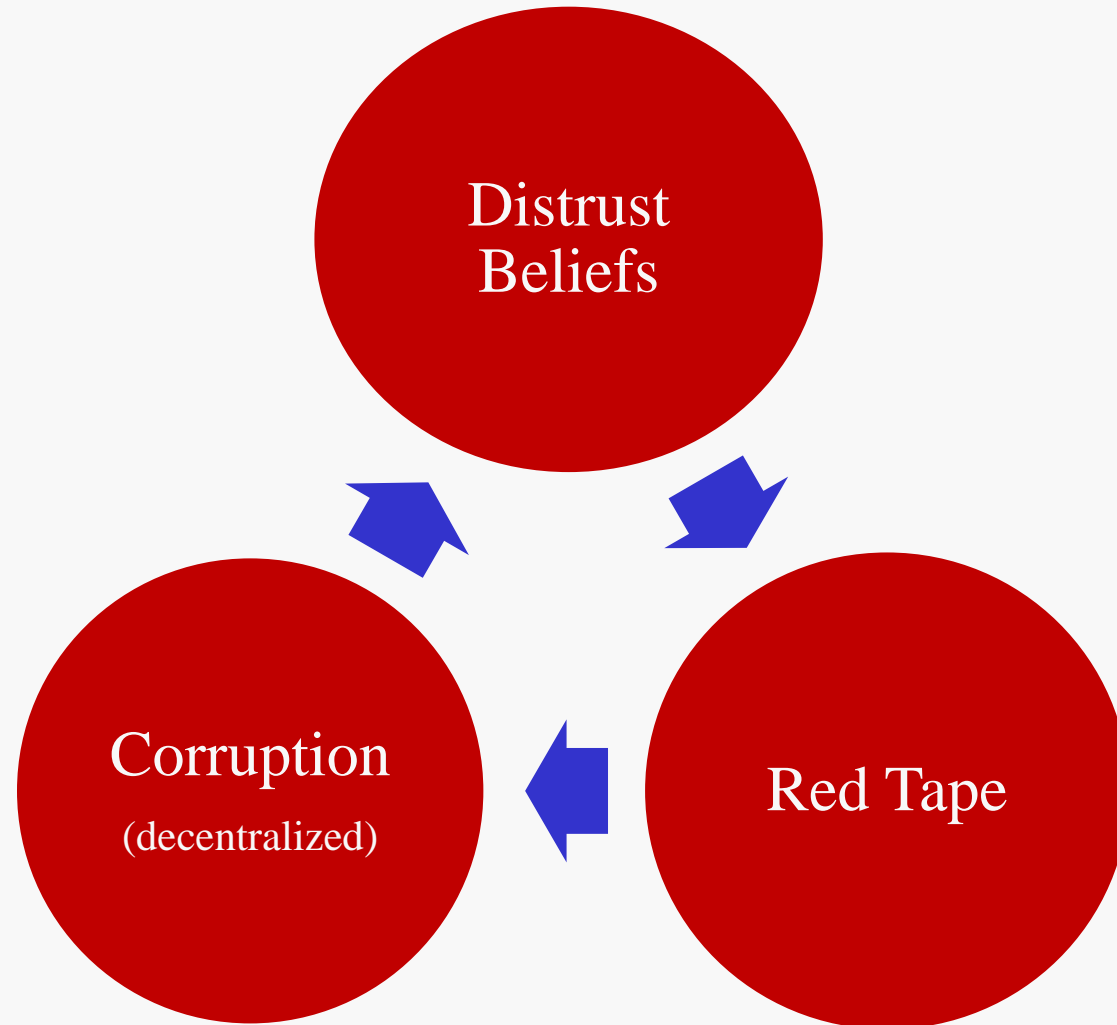
Policy

- **Distrust – Red Tape and Formalism – Corruption – Distrust**
- **Trust – Welfare State (Unemployment Insurance, Health) – Efficiency – Trust**

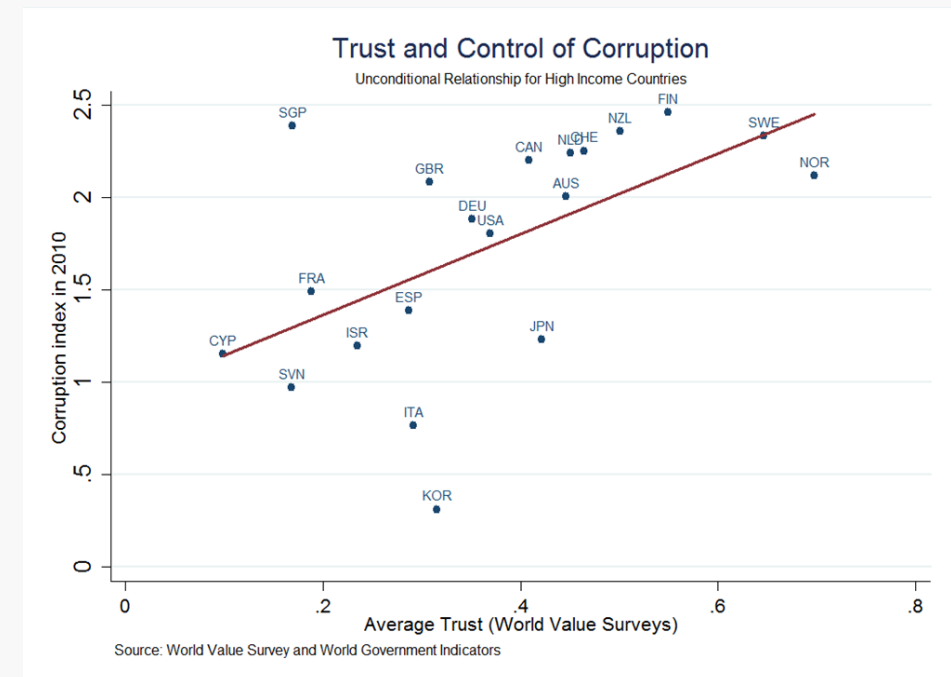
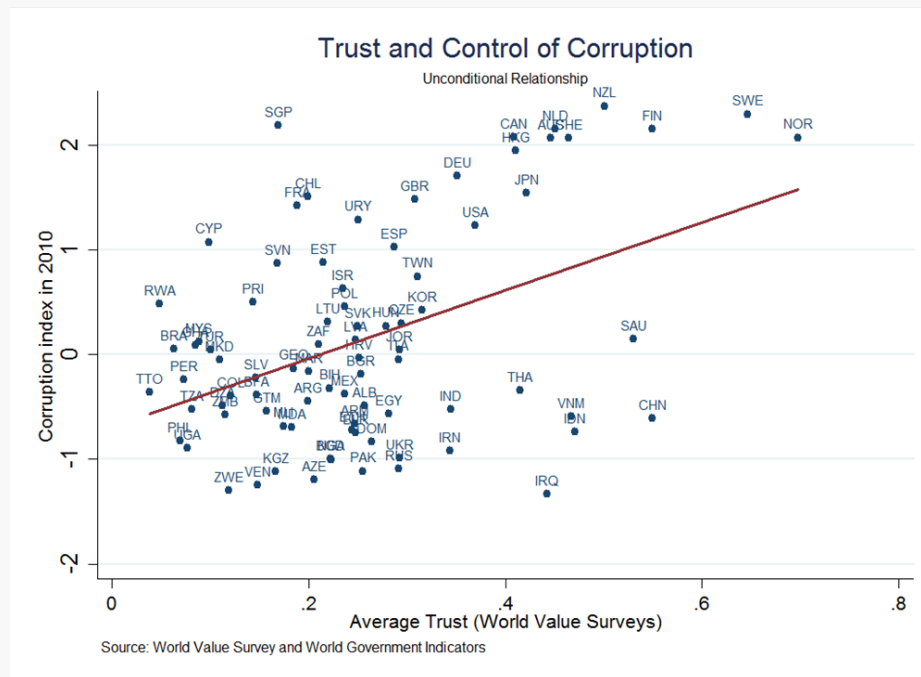
Management

- **Family Ties & Trust - Organizational structure & management quality – Distrust**

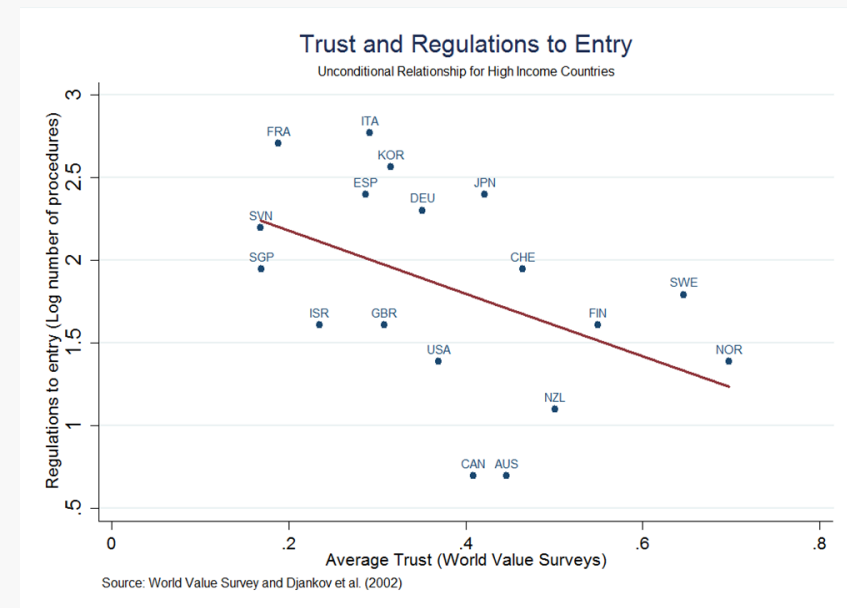
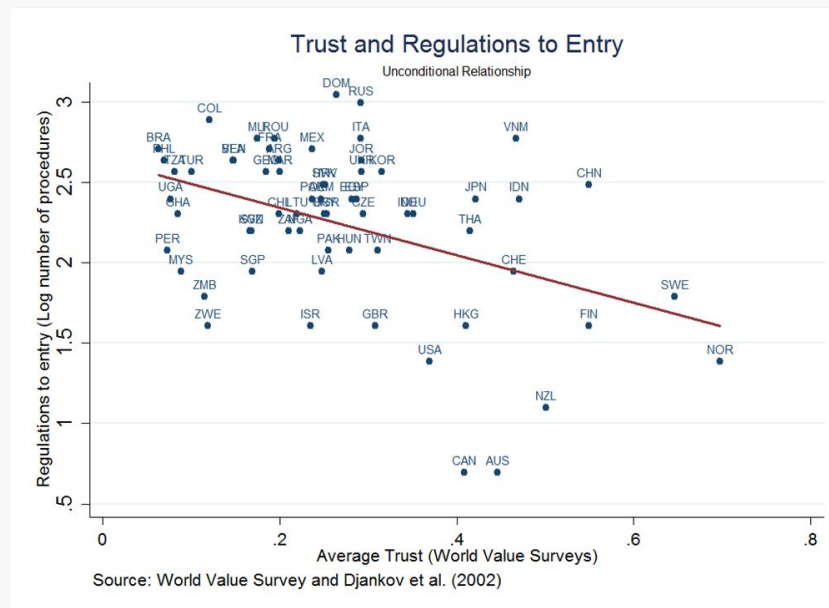
Distrust – Red Tape – Corruption



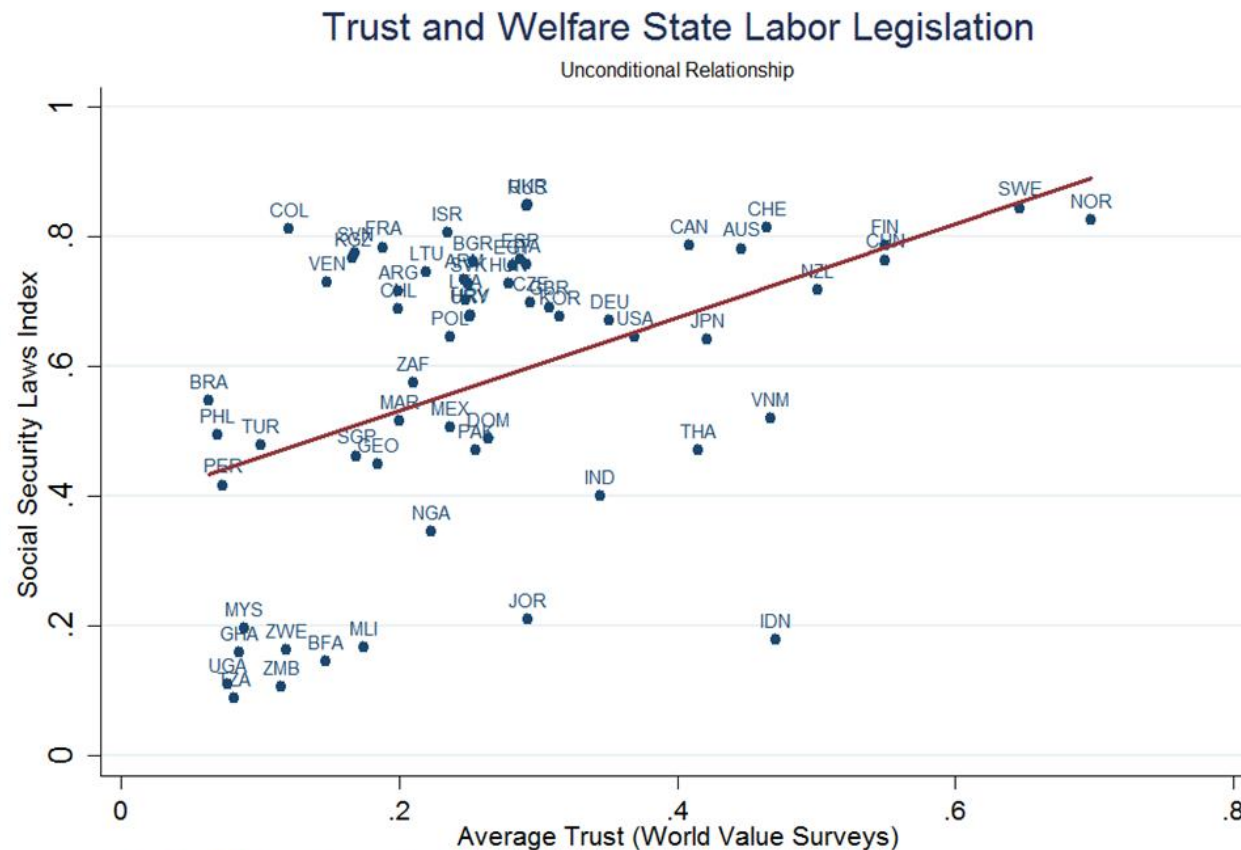
Trust and Control for Corruption



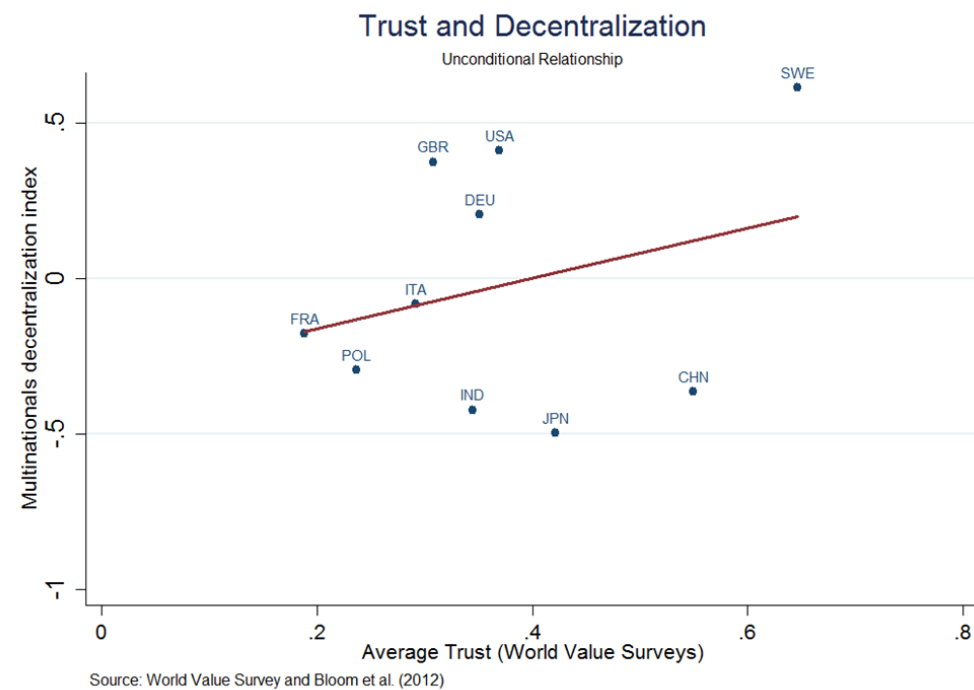
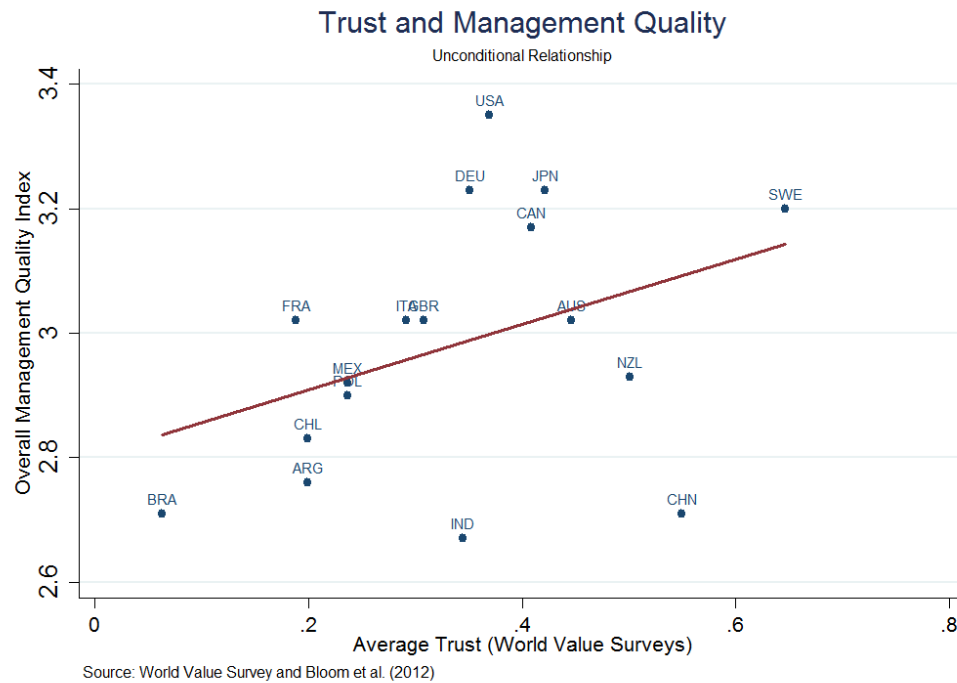
Trust and Red Tape



Social Capital and Welfare State Policies



Trust and Firm Organization



Back to Why?

Fiscal Conditions

[public debt, govt. deficit]

Competitiveness

[trade deficit, firm performance]

Trust & Civicness

[norms, beliefs, cooperation,
collaboration]

Institutions & Governance

[administration, judiciary,
regulation, corp. governance]

Looking Forward. GRecovery

Focus. Economics. Short-Term

- **Investment (local, foreign)**
- **Credit, banking, financial system [NPLs]**
- **Employment – labor utilization**
- **Fiscal discipline**
 - Commitment [MoU] vs. populist demands and weak institutions
 - MoU -> institution
 - Polloi?

Looking Forward. Grecovery, cont.

Focus. Institutions. Medium-Term

- **Public administration**
- **Judiciary, rule of law**
- **Regulation, red tape**
- **Corruption**
- **Governance**

- **Corporate governance**
- **Managerial practices**

Looking Forward. Grecovery, cont.

Focus. Beliefs, Civic/Social Capital. Medium/Long-Term

- Cooperation
- Inclusion
- Come together
- Trust

Grecovery. A Question of Trust

— **Evolution of Trust and proxies of Civic/social capital**

— **Opposing Mechanisms**

- Crisis
- Secular Trends [automation, globalization]
- Inequality and opportunity

The Fundamental Tensions

Civicness & Trust

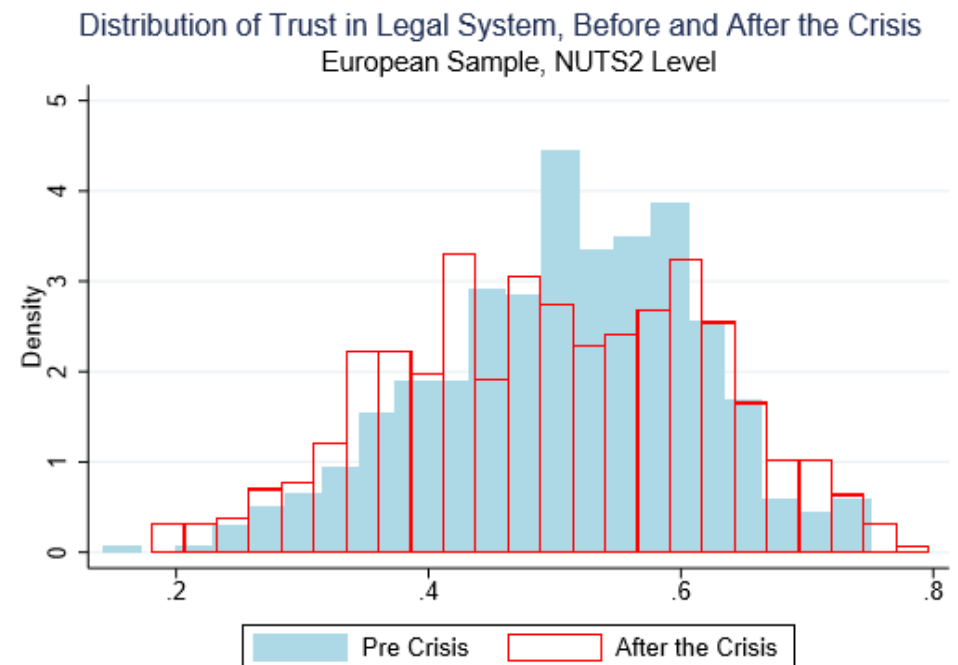
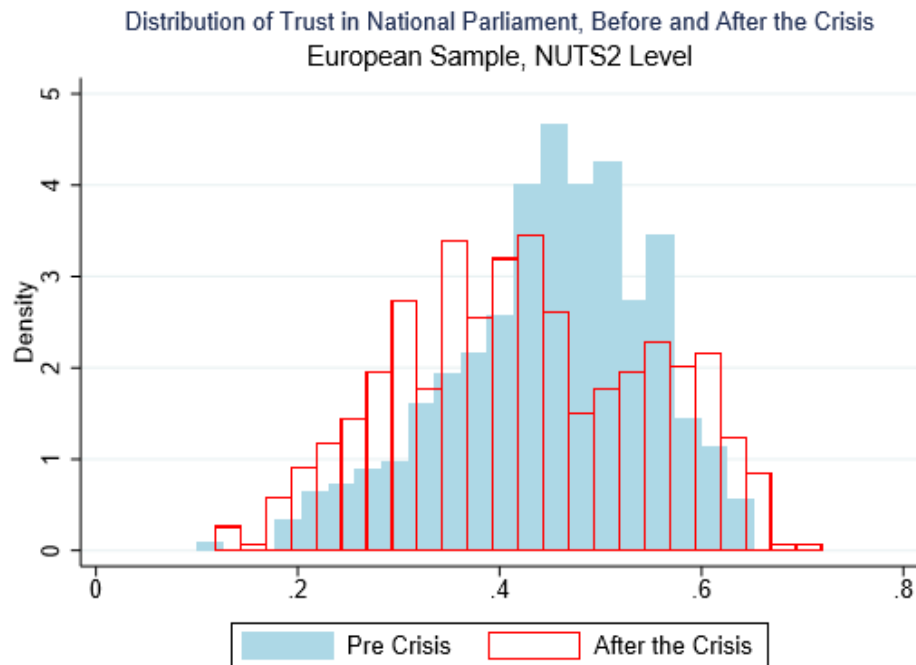
- Cooperation, collaboration
- Social & economic inclusion
- General trust (towards others)
- Trust towards democratic, capitalist institutions (courts, parties, parliament, etc)

Populism

- Distrust others, experts, media, etc
- Backwards looking
- Segregation
- Conspiracy
- “devil is others”

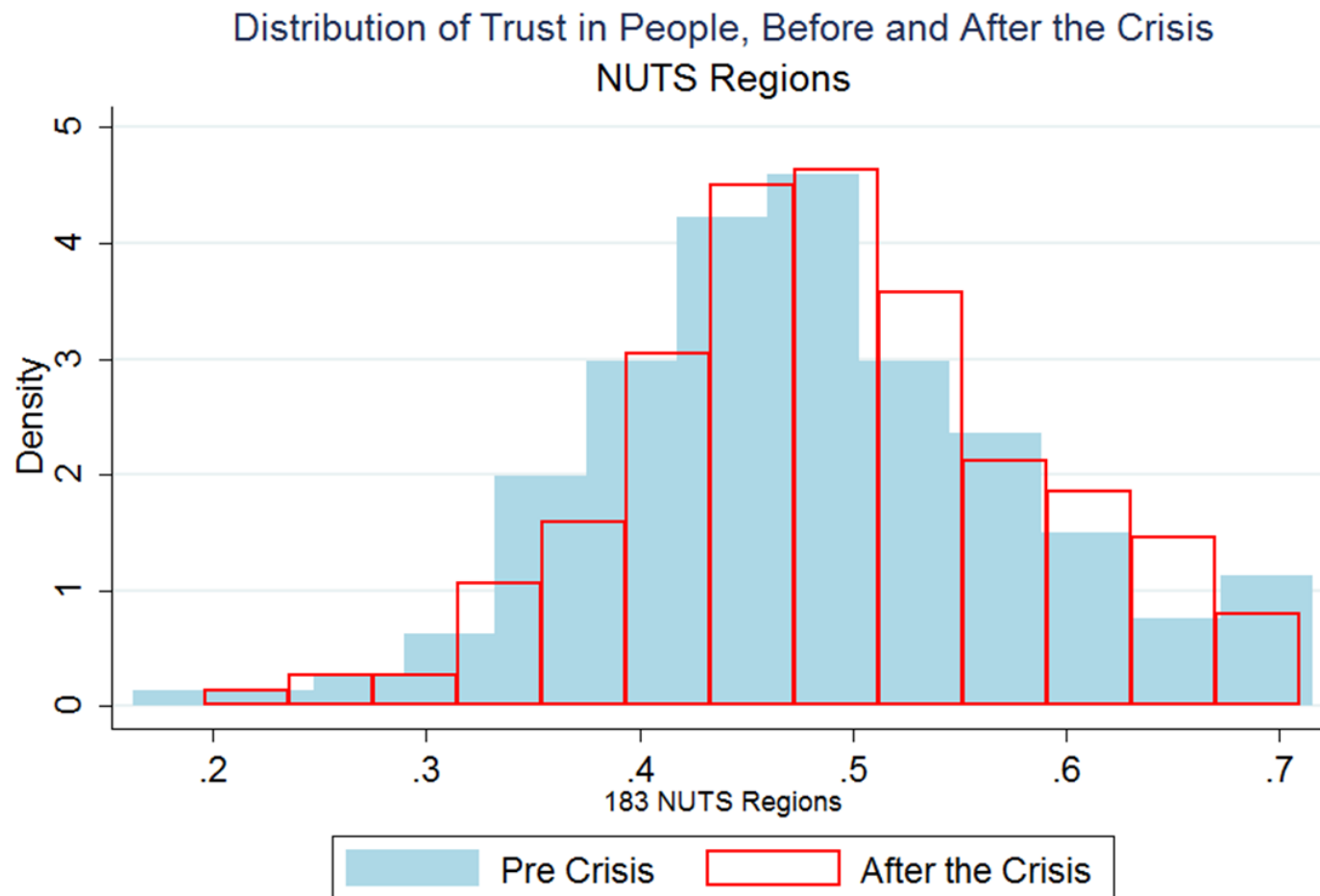
Beliefs in Europe before and After the Crisis

The Bad News. **Trust towards Parliament and Courts**



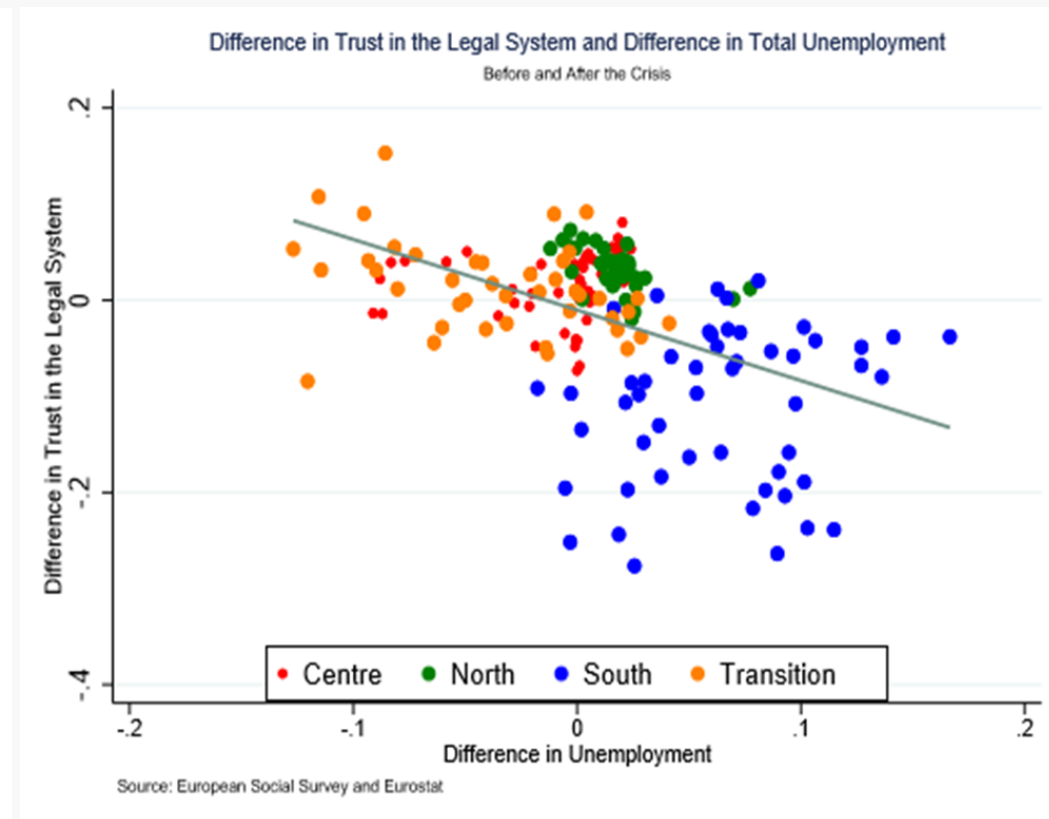
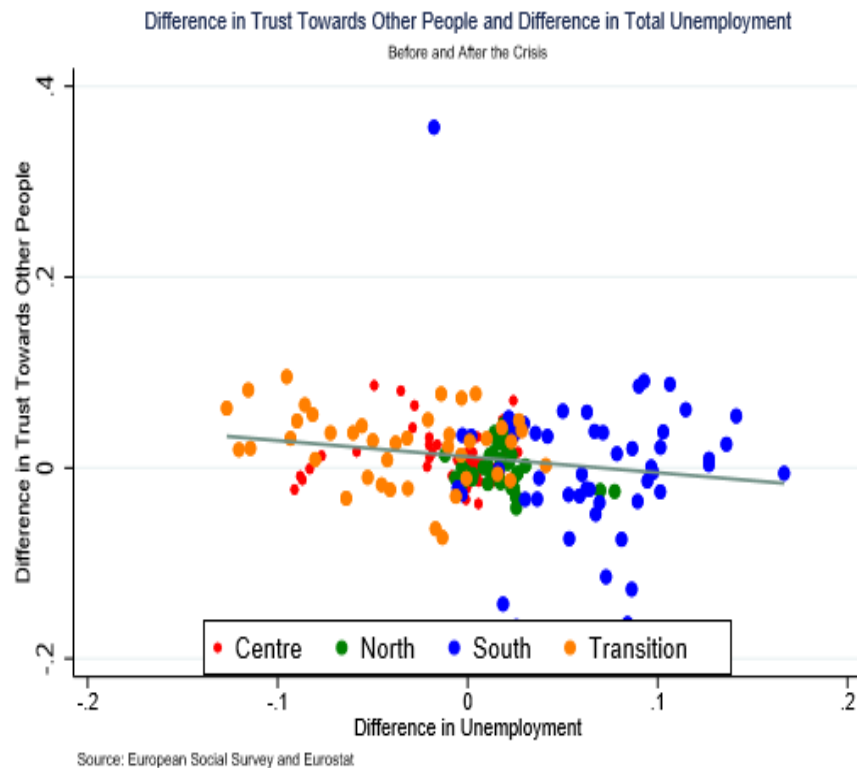
Beliefs in Europe before and After the Crisis

The Goods News. General Trust



Beliefs in Europe before and After the Crisis

Unemployment, General and Towards Institutions Trust



Drivers of Trust and Civicness

1. Deep historical factors

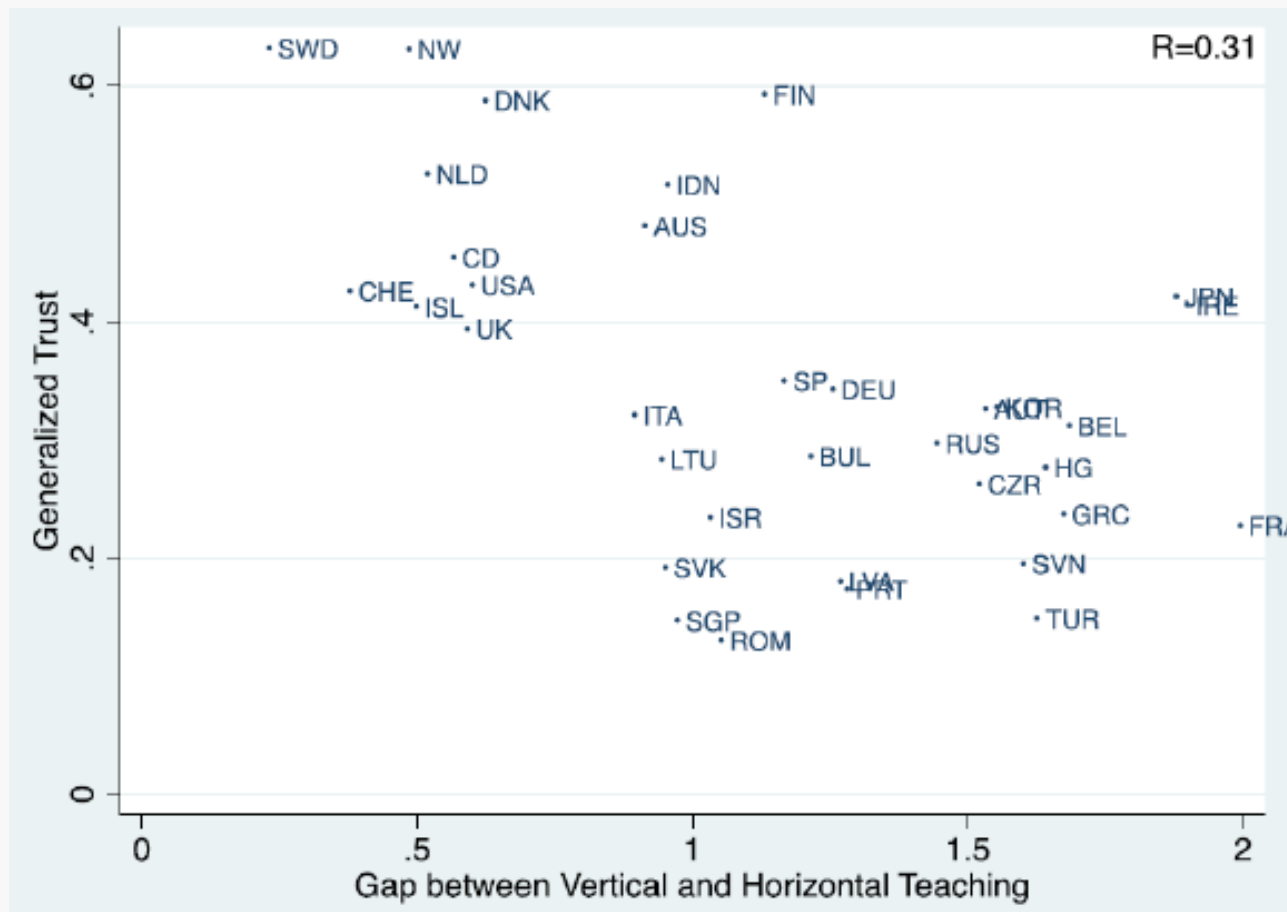
- Legacy of commerce
- Geography
- Important historical incidents [e.g., slave trades, black death, forced labor, Nazism, etc]

2. Policies

- Educational system type [horizontal, vertical]
 - Early interventions
- Competition
- Welfare state

Educational Policies [Vertical-Horizontal] and Trust

Algan, Cahuc and Shleifer (2013)



The Road to Grecovery. Analytical Framework

Economics

Investment (local and foreign), banking/financial system, employment.
Education policies => human capital accumulation

Institutions and Governance

Public. judiciary, product market regulation, public administration
Corporate. managerial practices, corporate governance

Trust & Civicness

cooperation, collaboration
Inclusion, social contract