

Democratic and Economic Consolidation in Southern Europe

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Over the last third of the twentieth century the landscape of Mediterranean Europe has changed radically. Previously, the region of Mediterranean Europe embraced the three most traditional societies and backward economies of Western Europe: Spain, Greece, and Portugal. These three societies and economies have undergone significant transformation. Their transformation is evident to any interested observer but is not a simple one, nor is it to be explained by a single argument or a solitary factor. It has been a process that involves politics, economics, international events, and global changes. The central question which informs this essay is about the role of politics and whether 'politics matters' in a process of economic and structural change. More specifically, the impact of democratization on fiscal policy and structure informs the central question. This question has at least two significant facets. The first inquires about the role of politics, as opposed to long-acting socioeconomic factors, in shaping paths of development and structural change. The second focuses on the influence of party politics and chosen policies upon processes of change. In this essay an attempt is made to capture both aspects of the role of politics in a specific historical period. In terms of the theoretical approach of the introductory chapter of this volume, we could say that both questions address aspects of large-scale transformations, such as modernization, democratization, and Europeanization, as well as aspects of past policy choices and institutional legacies. We can generally think of a sequence of questions that underlie the approach of the paper. Is the South European transformation the outcome of predetermination by earlier long-term factors, or is it shaped by political action? Does the choice of policies have a lasting effect? Is transformation shaped by domestic or international conditions? Does the balance of factors change as circumstances change and as the democratic regime matures?

Democratization is a central and common historical point in the process which the three societies and economies have undergone in the middle 1970s. With the hindsight of three decades, it can be argued that transformation without democratization would have been impossible. Even under the fairest economic conditions, transformation always involves choices for the allocation of scarce resources, strategies that eliminate or modify existing privileges, conflicts of interests and conflicts of visions. It therefore requires mechanisms that can reproduce and maintain a twin condition: legitimacy and stability of the sociopolitical arrangement. Democracies in Southern Europe have managed to produce this twin condition over the last quarter of the twentieth century. They have maintained their legitimacy and have gained both political and economic stability.

Focusing on the last third of the twentieth century requires that we have a basic understanding of starting conditions. The three South European countries shared two important features that were significant to their subsequent economic paths. The first common feature is important because it serves to illuminate existing systems: The state as an economic entity was *quite small* in all three countries. Total government outlays hardly exceeded a fifth of GDP of the three economies in the middle 1960s, as compared with a European average of over one-third of GDP at the same time. As systems of collection and distribution of resources, therefore, the southern states were small and weak, compared to their other European neighbors and future partners. The small economic size of the state in southern societies seems to contrast to the notion of the strong authoritarian state that many consider a standard historical feature of the three South European countries. This contrast requires comment. An authoritarian state may exercise economic intervention without being itself

economically large, that is, without directly collecting or spending monies. It can allocate resources by fiat, fix prices by decree, and can license some activities and forbid others.

Indeed, in all three countries the state wielded an extensive web of administrative powers for the regulation of economic activity. This made compatible the coexistence of authoritarianism with economically small public sectors. These forms of intervention however became harder to maintain in a context of rapid growth and new economic opportunities. Here it is relevant to recall the second common feature of the three economies: all three were star performers in terms of economic growth in the 1960s. For over a decade the three economies exhibited average growth rates near or exceeding 7 percent annually, with Europe at large growing at an average rate of about 4.5 percent annually. Thus, there was a powerful tendency for convergence but initial levels were of course still very disparate, and actual convergence was distant even at those differential growth rates. Nevertheless, high economic growth generated changes and new pressures within the southern societies. These had to be absorbed by existing systems of allocation of resources, benefits, and investments, and the ability of existing systems was therefore put to a severe test. The accumulation of private capital, the pressure of market choices, the opening of the economy to international competition were factors that inevitably pushed for the elimination of administrative interventions.

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In this process, these three southern states were presented with a new historical choice: on one hand, they could allow the private sector and the forces of the market to fill new spaces and needs created by growth, but maintain the public sector within its original small economic limits; on the other, they could opt for an economically active public sector which would base its activist role on the growth of its perimeter, through an expanding role in the collection and allocation of resources, rather than through antiquated regulation. The three South European societies followed the second route. It is argued in this chapter that democratization and European integration were powerful factors that determined the result.

The comparative approach is central to this essay and inevitably acquires a double dimension: a comparison of the three countries with each other, and a comparison of the three countries as a group with the 'European average'. Two points must be borne in mind about these comparisons. The first is that comparisons of the three countries with each other reveal important differences as well as common elements that always inform particular histories. There is no particular predilection to emphasize similarities beyond the obvious initial backwardness of the three societies. In fact, differences among the three are important because they reveal both the role of national politics and the limits and challenges of convergence to a common model. The second point is that the 'European average' is not a very clear standard of comparison. In this chapter the European average is represented by EU means and this clearly includes countries with very different social models, politics, and economic structures over the last quarter century. They represent a meaningful standard only insofar as they are all democratic and developed economies, belonging to an economic alliance. We therefore assume that convergence of the southern democracies to the 'European average' reveals an adjustment that makes them compatible and economically viable within the open space denned by the economies of their partners. This does not necessarily endorse the 'European average' as a meaningful or successful socioeconomic model.

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In this paper, the focus is placed on fiscal conditions and structures. These represent a specific but central part of the transformation that has absorbed the direct impact of both political and economic processes. The significance of the fiscal sphere for interpretation and analysis begets a special weight because of the importance that attaches to the public sector. Indeed, one of the major changes which is apparent over the last thirty-five years in the three South European countries is in the size, the role, and the structure of the public sector. The fiscal sphere condenses the interplay between economic forces and political choices. Its study can therefore be very revealing about the effectiveness of policies in pushing structural change. Even more to the point, the fiscal sphere is the epicenter of the social mechanism that can produce the twin condition of democratic support and stability. The success or failure of fiscal management can regulate the maintenance or elimination of the twin condition.

The process of transformation that the three South European societies underwent in the last thirty-five years of the twentieth century passed through distinct phases. The phase of democratization formed a transitional period that involved primarily the role of domestic factors and actors in each country. In terms of the approach employed in the introductory chapter of this volume, we could say that domestic institutions, leftover after the demise of past political regimes, were influential in the aforementioned transformation. Such institutions, and related norms and legacies, constrained fiscal policy-making. The phase of consolidation of democracy and of the European orientation of the three societies was characterized by the emergence of the importance of international factors, actors, and constraints. Finally, the phase of European convergence, which determined the definite path of the three southern democracies toward participation in the European Monetary Union brought fully to the forefront the forces and institutional pressures of the EU on its three least developed members. The shift of importance from domestic to international factors as we pass from each phase to the other is not only an important point from a methodological respect. It is also a substantial change in the makeup of political and economic forces that determined social outputs in the erstwhile backward and relatively isolated countries of Southern Europe.

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The Fiscal Legacy of Democratization in Southern Europe: Public Spending

The examination of the causes and the consequences of democratization in the three South European states can be subsumed under four questions. The first is whether the collapse of the dictatorships was the outcome of long-term forces arising from prior socioeconomic development or short-term forces related to economic crisis. Theory and evidence from other case studies suggest the possibility of both types of effect. The second is whether democratization had an immediate and visible fiscal effect. Democratization is almost synonymous with a demand for political rights. It is reasonable to hypothesize that it also engenders expectations for the provision of economic and social goods. This can lead to considerable expansion of fiscal expenditure, and must be tested in the case of South European democratization. The third question is whether the fiscal-expansionary impact of democratization, if it proves significant, is materially affected by national politics, the character of political parties managing democratization, and the ideological makeup of the forces leading the transition to democracy. The fourth question is whether fiscal expenditure expansion also mobilizes policies for revenue expansion and how are these policies dependent on national political conditions. These questions are analyzed in this section.

In the years 1974-6 the three dictatorships of Southern Europe were successively eliminated. Portugal, Greece, and Spain became young democracies and began, in that order, their process of transition toward stable democratic life on a road full of challenges and obstacles. The challenges were not only political. They were also economic, and formidable at that. It is remembered that 1973-4 was the period of the first oil shock that plunged the world economy into a serious crisis and created economic uncertainty of large proportions. Its first impact was on price inflation that jumped from 8.6 percent in 1973 to 13.3 percent annually in 1974 in the European Community as a whole. The three South European economies were much harder hit by this inflationary spiral: Portuguese inflation peaked at 29.2 percent in 1974, Greek inflation peaked at 26.9 percent in the same year, whereas in Spain the shock was milder, but nevertheless serious, with 15.7 percent in 1974. Continued inflation would be a serious problem for the young democracies.

The appearance of economic crisis shortly before the collapse of the three dictatorships furnishes a likely factor, but by no means an exclusive one, which heightened the pressures and hastened the establishment of democracy. It has been argued persuasively that as dictatorships seek to draw legitimacy from good economic performance, they also become vulnerable to economic crisis (Maravall, 1997: 6). The three South European dictatorships could lay claim on good economic performance, since up to 1973 their economies were the fastest growing in Europe. In any event, the very argument that economic crisis hastened the demise of dictatorships also serves to underline the difficulties that young

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South European democracies had to face, coming to grips simultaneously with a legacy of political and economic crises that were intertwined.

It is important to gain a macroscopic comparative view of economic development prior to and during the period of democratic transition of the three South European economies. In Table 8.1 are shown GDP growth rates, inflation rates, growth rates of real investment, and growth rates of government consumption spending, over three subintervals of the period 1960-79. The three South European economies are compared to the benchmark of corresponding averages for the EEC.

Table 8.1 Economic performance, 1960-79

	1960-8	1968-73	1973-9
GDP annual growth rates			
Greece	7.3 %	8.2 %	3.7 %
Spain	7.5	6.8	2.5
Portugal	6.6	7.4	3.1
EEC average	4.6	4.9	2.4
Annual growth rates of fixed investment			
Greece	9.5	10.6	-0.2
Spain	12.5	7.8	-1.1
Portugal	6.0	10.7	-0.2
EEC average	5.9	4.9	0.3
Consumer price inflation			
Greece	1.9	5.6	16.1
Spain	6.6	7.1	18.3
Portugal	3.2	8.4	23.7
EEC average	3.6	6.1	11.1
Annual growth of government consumption			
Greece	6.2	6.2	7.5
Spain	4.1	5.3	5.4
Portugal	9.4	6.6	9.2
EEC average	3.9	3.8	3.0

Source: OECD (1986).

In the interval 1960-68 we can gain the basic characterization of the decade. The three South European economies were model performers. Their economic growth rates were much higher than those of EEC countries. Inflation rates were lower in Greece and Portugal, compared to the EEC. Spain however was a clear exception on the inflation front, with an average annual rate of 6.6 percent, which for the standards of that period was quite high. The growth of real investment was also very high in Greece and Spain and slightly over the European average for Portugal. The growth of government consumption, that is, the purchase of goods and services by government, was generally higher in the three southern economies than in the EEC, but this was not inconsistent with the much higher general growth rates that these economies enjoyed.

The period 1968-73 has been separated out in the Table in order to furnish a more immediate, but again sufficiently representative, picture of economic conditions prior to democratization. The strong performance of the southern economies continued and the only significant change is that inflationary pressures built up everywhere during this period. The acceleration of consumer price changes was appreciable in Greece and Portugal, but small in Spain where the inflation rate was already higher in the previous interval. Of course, inflation of consumer prices also accelerated in the EEC. Nevertheless, it can be surmised that a more than doubling of the inflation rate in the two poorest countries of Europe, Greece and Portugal, had a negative political impact on the respective dictatorships.¹ Gathering inflationary pressures notwithstanding, the broad picture that emerges is that until the time of energy crisis, the three South European economies had been growing substantially faster than

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their European neighbors for over a decade and a half, and had been experiencing conditions of macroeconomic stability at the same time. This long period of economic boom undoubtedly fostered incomes and economic well-being in the European south. Equally undoubtedly, it brought to the fore new pressures and expectations for the fairer distribution of the benefits of growth, and for change that would accommodate new activities and new initiatives.

The contribution of economic progress to the 'obsolescence' of the long-standing dictatorships in Spain and Portugal can be analyzed at many levels. A meaningful approach focuses on the machinery of policymaking and policy outputs under a dictatorial regime.² Yet, the long economic boom cannot be taken as a sufficient condition for democratization in Southern Europe. Three arguments support this. First, on a theoretical level the long boom may have in fact increased support for the existing regimes and presented them with new margins for political and economic reforms which would offer palliatives but not harm the fundamental character of the regime. Second, contrary to the Iberian countries, in Greece the direction was reversed. A military dictatorship was established in 1967, precisely in the midst of the economic boom. It is nonsense to ascribe the later collapse of the same dictatorship to the same economic boom. Third, as history always takes its revenge on experimental social scientists, the observations from the 1970s are not clean. Economic boom ended relatively abruptly in the middle 1970s, not by a measured economic slowdown but by a sharp crisis. The experimentalist is placed in a quandary: did South European democratization result from long boom or from sharp short crisis? The question itself is misplaced, of course. Economic conditions cannot sufficiently explain change, but they can offer powerful insight into the choices, the challenges, the demands, and the constraints which shaped policies and policy outputs. In the case of South European democratization, considerable insight can be gained by looking at the last column of Table 8.1, and at how sharply conditions changed in the 1970s, as compared to the 1960s.

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The period of the two energy crises is captured fully in the observations of the interval 1973-9, and this was clearly a time of sharp economic problems for the three South European economies. Average growth rates halved, inflation rates almost tripled, real new investment evaporated. These features paralleled developments in the EEC, except that there the changes were much milder. The fragility of the weaker economies of the European south became obvious, at precisely their time of crisis and general economic malaise. From a more macroscopic viewpoint one might also argue that as the economies of South Europe had overtaken their northern neighbors during the boom, so they also overtook them, in the negative direction, during the sharp recession following the energy crisis. This formalism however does not capture the important specificity of democratization that intervened in 1974-6. The societies of the south had to put together new political institutions, to engage in the reconstruction of democratic politics, while at the same time they had to come to grips with their worse economic crisis in almost two decades. The economic effects observed after 1973 in the three economies of the south embrace both the impact of the international crisis and the features of the national collective path to democracy.

Democratization is almost synonymous with a universal demand for political rights. Its primary content is therefore the provision of 'political goods.' Yet, the liberation of expectations and of pent-up demands for wages, economic well-being, social protection, and economic opportunity always appear simultaneously, as they are anchored in repressed needs from the undemocratic past. Thus, it is normal to expect that democratization will heighten pressures for the provision of 'economic' as well as 'political' goods. If, in addition, an economic crisis is present, the need for protection from the effects of the crisis can become a heated political issue in economic policy choices. On the part of those who shape policy, the need to gain legitimacy is heightened during a period when political forces seek to put together a new democratic order that can work, while engaging in competition with each other at the same time. The basic hypothesis suggested by this argument is that the primary fiscal response to democratization will be an increase of public expenditure, since this is the most

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readily available instrument with which democratic governments can quickly accommodate demands for protection and build support for their exercise of economic policy.

A careful look at the last panel of Table 8.1 gives a first indication of the verification of the hypothesis in the case of the three southern economies. In the lowest panel are shown the growth rates of government real consumption expenditure.³ Observing these growth rates, we note that in all three countries they accelerate in 1973-9 as compared to 1968-73. This happens despite the fact that the overall rate of economic growth in these countries is reduced by more than half at the same time. It also diverges sharply from the European trend, where the rate of growth of government consumption declines appreciably from an average of 3.8 percent in 1968-73 to an average of 3 percent in 1973-9. Furthermore, it is also notable that there are large differences among the three southern countries. The rate of growth of government consumption jumps to a high level in Portugal (9.2 percent), to an intermediate level in Greece (7.5 percent), and to a level only slightly higher than in the previous period in Spain (5.4 percent). This significant variation between the three is repeated in other evidence, and is interpreted more fully below as the outcome of widely divergent political paths followed in the three countries during the course of democratization. Consistent with the logic of path dependency, different policy choices made earlier in the transition period eventually constrained the range of policy options which were available later in the consolidation process. Portugal's transition was managed by and large by leftist forces, whereas Greek and Spanish transitions were managed by moderate-conservative governments. National political differences played an important role in the pattern and structure of fiscal impacts of democratization, as we observe in a later part.⁴

To look more closely at public expenditure during the years of democratic transition we can consult the data in Table 8.2, where are shown current disbursements of government as a percent of GDP, and their main components (consumption, social security, other transfers) over the interval 1973-9. The data of Table 8.2 offer a more detailed view than the broad averages of Table 8.1.

Table 8.2 Government expenditures as percentage of GDP, 1973-9

	1973	1974	1975	1976	1977	1978	1979
Greece							
Consumption	11.5	13.8	15.2	15.1	16.0	15.9	16.3
Social security	6.8	7.1	7.4	7.7	8.5	9.2	8.8
Other	2.8	4.1	4.1	4.6	4.5	4.8	4.6
Total	21.1	25.0	26.7	27.4	29.0	29.9	29.7
Spain							
Consumption	8.6	8.8	9.2	9.8	0.0	10.4	10.9
Social security	9.6	9.5	10.3	11.1	11.7	13.2	14.5
Other	1.5	1.5	1.7	1.9	2.0	2.6	2.3
Total	19.7	19.8	21.2	22.8	23.7	26.2	27.7
Portugal							
Consumption	12.8	14.1	15.0	13.7	14.0	13.9	13.9
Social security	4.6	5.3	8.6	11.6	10.8	10.1	9.5
Other	2.1	3.3	3.6	5.6	6.8	7.8	7.8
Total	19.5	22.7	27.2	30.9	30.8	31.8	31.2
EEC average							
Consumption	15.7	16.6	17.5	17.3	17.2	17.4	17.4
Social security	13.6	14.3	16.3	16.6	16.9	17.3	17.3
Other	5.1	5.4	6.0	5.9	6.1	6.5	6.6
Total	34.4	36.3	39.8	39.8	40.2	41.2	41.3

Source: OECD (1986) Tables 6.2, 6.3, and 6.4. Note: The computation of 'Other' is made by subtracting consumption expenditures and social security transfers from total current government disbursements.

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Within seven years of democratization in South Europe, the current expenditures of southern governments gained an order of magnitude of 10 percentage points of GDP, moving from the region of 20 to the region of 30 percent. This constituted a huge increase of government spending and its weight in the overall economy. Thus, there is to be no doubt that the young South European democracies chose to wield the tool of fiscal expenditure generously. The general economic crisis made this all the more necessary, as it apparently did in all EEC countries. The expansion of government spending was a general phenomenon, but the EEC averages grew more slowly, and by less than South European rates of spending. Nevertheless, we must also observe that South European governments started from very low levels of spending compared to the rest of Europe. Thus, even after the intense increases in the 1970s, government spending levels as a percent of GDP remained roughly 10 percentage points lower in South Europe than in the EEC. Nevertheless, with the mediation of economic crisis, and the pressures of democratic politics there was a measure of convergence between the south and the EEC in the 1970s.

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The broad similarity in overall spending growth among the three southern states recedes when we look at greater detail of time pattern and structure. In Greece and Portugal, most of the growth of the share of public expenditure takes place by 1977. In Spain, on the contrary, growth is rapid after 1976. Domestic politics explains these differences. In Greece, an election was held in 1977, and the conservatives who had ruled since 1974 were seeking to consolidate their own prospects, in part by boosting public expenditures, and were successful.⁵ In Portugal, the political upheavals, the sharp movements from Right to Left, a wave of nationalizations, salary and pension increases, and other attempts at rapid redistribution measures explain the huge increase of current public expenditure as a percent of GDP from 19.5 in 1973 to 30.9 in 1976. It is notable that in the remainder of the period, the only component of Portuguese expenditure that grows is 'other transfers' that by and large consists of interest payments on debts that were run up in prior years. This item was higher in Portugal than in any of the other two countries, and was a direct result of the earlier explosion of public spending.

In Spain, the growth of public expenditure as a share of GDP is concentrated in later years, notably after 1976. In fact, until 1976 Spanish public expenditure grows much less than the EEC average. It is probable that, as a result of the gradualist type of Spanish transition, the pressures for expenditure growth that had appeared much earlier in the other two countries, became operational in Spain only after the general election of 1977. It was soon after the election that the UCD government succeeded in establishing the Moncloa Pacts in the autumn of 1977, that committed the major political parties to a macro-economic stabilization plan and to a number of reforms in the area of social protection.⁶ The growth of public expenditure after 1977 was in large part due to social security outlays, as can be seen from the data of Table 8.2. This was the outcome of both policies, as embedded in the Moncloa pacts, and circumstance. Unemployment rose continually in Spain throughout this period, and it would be expected that social security spending would experience substantial pressure. This is also evident in EEC averages where the rise of social security spending over the interval 1973-9 takes up more than half the total increase in public spending in that period. It is impossible to ascribe the increase of social security spending specifically to political causes. It is nevertheless notable that both in Portugal and Spain the combination of democratization and economic crisis appeared to force something like a break in a barrier: social security transfers acquired the role of driving factor for the augmentation of public expenditure. Again, Greece is at variance in this instance. The primary category of expenditure increase in Greece was direct government consumption spending. This reflected both the facts that unemployment did not rise as sharply in Greece at that time, and the implicit policy choice to maintain employment levels by maintaining public sector hiring as a tool against unemployment.⁷

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The data and analysis so far enable the formulation of a central argument. National politics and institutional constraints shaped the paths and patterns of change in public expenditure of the young southern democracies, but the substantial overall growth is still the

overriding common characteristic. The combination of economic crisis and democratization furnished a powerful impetus for an expansion of the spending role of government. Change in the southern democracies was rapid. Within six years the share of public spending in GDP grew by 50 percent, whereas in the EEC it only grew by 20 percent. As a major feature of the period of democratization, the very large growth of public spending created an obvious fiscal requirement that could put to the test the stability of the economies and the viability of the fiscal system: growing expenditures had to be financed. Debt finance is an immediately available response which usually presents few political problems but can lead to major economic problems. Debt becomes a cause of erosion of fiscal confidence as it accumulates. Tax finance, on the other hand, is politically more difficult to impose but economically a more appropriate response that avoids the destabilization caused by deficits and the accumulation of debt.

Policies to increase taxes are politically as difficult as policies to increase expenditures are easy. At times of economic crisis when economic relief is high on the political agenda, the collection of additional taxes is a challenge for governments. In the period of democratization in the European south, the additional pressures of legitimization, acceptance of democratic processes, and political competition created obvious tendencies for policymakers to put off reforms and policies that would bring about a radical increase in taxation to match the evolving radical increase in public expenditure. As a general proposition, this must be moderated by two considerations. The first is that some tax increases normally follow increases in expenditures: Public expenditures create new taxable incomes both by pushing existing incomes onto higher tax brackets and by drawing resources from the unofficial (and untaxed) to the official economy. The second is that governments can overcome political resistance to increased taxation if they manage to present persuasively the fairness, the 'just character' of the taxes. Measures for the elimination of tax evasion, policies of increased progressivity of taxes, campaigns against tax fraud furnish classic cases where tax reform can become a vehicle for gaining rather than losing public support for economic policy on account of taxes. In the particular case of the period of democratization of the three South European economies, the response of tax revenues to the needs created by the great increase in expenditure is therefore an empirical question. It depended on the extent to which governments of the period were able to overcome the circumstances and political constraints of the times.

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Tax receipts and social security contributions in four signal years are shown in Table 8.3. They are computed as percentages of GDP.⁸

Table 8.3 Tax and social security receipts as percentage of GDP

	1965	1970	1975	1980
Greece				
Tax receipts	12.4	14.6	14.8	16.1
Social security	5.7	6.3	6.2	7.9
Tbtal	18.2	20.9	21.0	24.0
Spain				
Tax receipts	10.5	10.6	10.3	11.8
Social security	4.2	6.3	9.3	11.1
Total	14.7	16.9	19.5	22.9
Portugal				
Tax receipts	12.4	15.1	13.9	17.3
Social security	3.5	4.7	7.3	7.3
Total	15.8	19.8	21.2	24.6
EEC average				
Tax receipts	21.5	23.9	24.8	25.6
Social security	6.3	7.3	9.3	10.1
Total	27.8	31.2	34.1	35.8

Source: OECD (2000), Tables 3, 4, and 14.

An immediate and general observation is that between 1970 and 1980, the interval in which we would expect to capture the tax effects of transitions to democracy, taxation as a share of GDP grew very little in all three southern economies, with Spain remaining by far the lowest. From 10.6 percent of GDP in 1970, Spanish tax revenue amounted to 11.6 percent in 1980. This is also observed for the European average, where tax share grew very little. It would appear justified to conclude that in the midst of economic crises, additions to tax burden were not politically feasible or desirable anywhere, all the more in the young democracies of Southern Europe. The picture changes considerably if we look at social security contributions. We saw already, when studying expenditures, that social security outlays absorbed a large portion of the increase in total public expenditure in the late 1970s. Here, we observe that social security contributions also underwent considerable increases from 1970 to 1980. Spain is the front running case with contributions rising from 6.3 percent of GDP in 1970 to 11.1 percent in 1980. This was a very large increase. Increases in Portugal and Greece were respectively lower than in Spain, but in both cases social security contributions expanded more than taxes. If we compare the three southern economies to the EEC average we note that in the EEC also social security contributions grew faster than tax receipts over the relevant interval, going from 7.3 percent of GDP in 1970 to 10.1 percent in 1980. From a quantitative point of view, the rapid growth of social security receipts, especially in Spain and Portugal, led to visible convergence of social security receipts between the southern democracies and the EEC. This is an important observation and can draw both economic and political interpretation.

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The large expansion of social security contributions was a rapid response to the increase in the corresponding expenditures, which were clearly driven by the looming economic crisis of the 1970s. Since in all three southern countries, as in most of Europe, social security is funded separately from the general state budget and operates as an autonomous system, its receipts are earmarked and can be directly tied to the finance of expenditure. This transparency of use and the flow-through character of the link between receipts and expenditures within an autonomous system, make it easier to calculate, enforce, and justify politically increases in social security contributions. Indeed, the three southern democracies made this adjustment as the most significant step toward the rectification of fiscal deficits that were created by large increases in social spending. Both in terms of fiscal behavior and in terms of the size of the intervention in the area of social security, the three southern economies exhibited convergence upon the EEC average. The international crisis of the 1970s must be clearly credited with this convergence.⁹

The three young democracies of Southern Europe successfully survived the challenges of transition from dictatorship in the midst of a serious world economic crisis in the 1970s. Their states were traditionally small and relatively weak economic entities. Taxing and public spending as shares of GDP were the lowest in Europe. Their economies had undergone spectacular economic growth in the sixties, leading their societies to increased well-being (but also giving rise to new demands), and leaving their states with budget surpluses and monetary stability. The economic crisis of the 1970s may have contributed to the demise of the dictatorships, but its most prominent characteristic was that its effects mingled with the political requirements for democratic legitimacy, and produced specific and large changes in the fiscal order of the three southern economies. The economic role and size of the state grew rapidly. Public spending was enlarged with social expenditures leading the way, as would be expected in times of crisis and as trends in all of Europe also showed. Public receipts were much slower to increase, thus implying that the young democracies had to forego their previous surpluses and finance expenditures through borrowing. This would then present them with a major challenge in the ensuing period when they undertook to consolidate their democracies by ensuring, inter alia but importantly, the stability and growth potential of their economies.

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The politics of transition in each country played a large role in the structure and the time path of responses to the challenges of crisis. The left-wing forces that dominated early in

the Portuguese transition brought about rapid institutional changes in the economic role of the state that then translated to fiscal results. On the other hand, the moderate-conservative governments which managed the transitions in Greece and Spain did not subscribe to radical institutional shifts but did follow a policy of avoiding major economic conflicts in order to maintain and strengthen the legitimacy of the democratic order. Again these policies translated to specific fiscal results. The growth in the economic role of the states in Southern Europe was clearly fostered by the sense of democratic empowerment which dictated interventions in the economy at a time of a serious international and national crisis.

Consolidation of Democracy and the Economy

The democratization of the South European societies during the economic crisis of the 1970s left their states open to two major challenges. One was a broad agenda of economic reform that related to opening up the economy, wiping away protectionist barriers, deregulation of markets, and elimination of subsidies to failing firms. The second was the economic viability of the state itself. This required a resolution of the fiscal dilemma which early and rapid growth of public expenditure had posed. Accumulating deficits are not sustainable. They affect the stability of the economy and endanger its growth. They must be cured either by a rolling back of expenditure or by an increase in receipts. Both options require tough policies. The importance of these challenges for the young South European democracies was not confined to the sphere of economic policy. It had broad political significance. After the turmoil of political transitions in the 1970s, the ability of economies to perform well and to fulfill the expectations which had accompanied democratization became more and more a question about whether democracy could fulfill its promise. Furthermore, after the crisis of oil prices, politicians all over Europe and the world were making a central issue of the need to craft new policies that would guide the developed economies to a new paradigm of economic stability and development. Thus, issues of policy and economic structure were central to political agendas everywhere, all the more so in the young democracies of the European south. The quest for democratic consolidation inevitably overlapped with the need for economic consolidation and the crafting of institutions and policies that would produce new economic growth. This did not leave South European policymakers indifferent. Their aspirations for European Community membership and international linkages were important factors in shaping their own responses to crisis and adjustment.

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The transition to democracy in Southern Europe was linked from its early stages to a strategy of European integration. The isolation of dictatorships from Europe and from the important economic and political trends that were evolving in the European Community was one of the major failings that the new democracies had to address. Indeed, important political forces in all three countries explicitly placed European integration high on their agenda. These included all moderate and conservative parties, as well as socialist parties in Spain and Portugal. In fact, it was the socialist parties of these two countries that negotiated as governing parties the accession of Spain and Portugal to the European Community in 1985. The Greek accession was prepared by governing moderate-conservatives under Constantine Karamanlis. PASOK, the Greek socialist party voiced early objections to membership in the EEC, but fully accepted it when it was obliged to manage, as governing party, the early steps of Greek membership in 1981. The majority of the electorate in each of the three South European countries was constantly in favor of European integration, although on occasion strong dissenting voices were raised.

The commitment to European integration had deep political and economic implications. On one hand, it signaled a permanent reinforcement of the democratic order in Southern Europe, by linking national to European institutions through the growth of political and economic interdependence. On the other hand, it also signified that the Southern European countries would have to move quickly to open up their economies and to abide by European Community norms, standards, and common policies. The imposition of fiscal

discipline, better control of deficits, and the elimination of inflation were among the major issues that would weigh on the ability and the success of the economies of the south to integrate with those of their European neighbors. The legitimacy of policies that would lead to the correction of macroeconomic imbalances would be reinforced by the strategy of European integration, since economic reform would become part and parcel of each-country's European agenda. The link between European integration and the correction of domestic economic imbalances was not reinforced by domestic political debates alone. It was also directly invoked in negotiations between the European Community and each southern country, either in accession talks or, much later, in the preparations for participation in the European Monetary Union. The effectiveness of this external pressure varied among countries however, if one is to judge from post-negotiation behavior. Although this is a point that will be taken up later in this section, there is no doubt that the strategy of European integration was a source of internal and external pressures for pushing through economic and fiscal reforms in each of the three countries of Southern Europe.

Σχόλιο [SDP17]: p.321

The overriding need for economic stability and fiscal consolidation became a pressing political priority in the European Community. In the years after the second oil shock, the Community went through one of the worst periods of its history in terms of economic conditions. Stagnation and inflation settled on the European economy in the early 1980s. The real GDP growth rate in Community countries declined from an annual average of 2.4 percent in the period 1973-9 to 0.9 percent in 1980-4. Inflation hovered around an average of 10 percent at the same time, and real investment showed an average annual decline of 0.5 percent in 1980-4—a rare exception in the Community's history. The protracted crisis that combined inflation and economic stagnation gave rise to the quest for strong policies that would move the European economy forward. The strategy of deepening integration and formation of a true 'internal market' started taking shape in that period (see Tsoukalis 1997, Chapter 3, especially 33-40). Part and parcel of that strategy was the need to impose and maintain macroeconomic stability in each participating economy, and this, of course, imposed a serious constraint on the economies negotiating entry in the 1980s. Spanish and Portuguese policymakers, who were actively seeking EEC accession in the early 1980s, could not ignore this constraint, nor could they operate outside the emerging economic policy paradigm of the internal market and the stabilization of exchange rates in the European Monetary System.

An important historical aspect of democratic consolidation is that in the 1980s, there were important political shifts in all three countries. Socialist parties came to power in Greece and Spain, where moderate-conservative parties had previously managed the transition, and these socialist parties would govern throughout the decade. In Portugal where the transition was dominated by extra-parliamentary forces and strong leftist movements, parliamentary politics and parties had started to regain center stage already since 1979. The coalition of socialists and centrists of Bloco Central led by Mario Soares that came to power in 1983 would be succeeded in 1985 by the conservative PSD government of Cavaco Silva that would remain in power through the end of the decade. The alternation in power of major political parties and the formation of stable governments by parties that were in the opposition early in the transition process was practical proof that democratic consolidation had been achieved. The three South European societies were maturing as solid democracies that could accommodate the alternation of parties in power.

Σχόλιο [SDP18]: 322

The serious economic crisis of the early 1980s, that pushed for a change in European policies and for a new policy paradigm for the deepening of economic integration in Europe, affected the stance of the EEC in negotiations with the Iberian countries for accession to the Community. Greece had already become a member in January 1981. Since the new policy paradigm in Europe had not yet emerged as clearly as in the early 1980s, it can be surmised that Greek entry was much more affected by political considerations in the context of democratic transition than the accession of the Iberian countries would be. Besides the effects of explicit European policy, however, we must also repeat that the economic crisis had a direct impact, since a worsening European economy also implied a worsening of conditions

for the southern economies. In fact, in the period 1980-84, the southern economies' growth rates were the lowest of the postwar period, and their inflation rates were the highest.¹⁰

All three countries were therefore hard pressed to undertake programs of economic stabilization in the 1980s. In Spain, the new socialist government that was elected in 1982 promptly implemented a stabilization plan that included severe macroeconomic and monetary restraints. In Portugal, the Bloco Central under the leadership of Soares also put in place a stabilization program in 1983. In Greece, the socialist government undertook stabilization only after its reelection in 1985, and a severe program of demand restraint was to remain in effect for two years.¹¹ The important point is that, in every case, a shift toward very unpopular economic policies was undertaken with a fresh electoral mandate and by a political party that rose to power as an alternative to the one that had managed the transition to democracy. That an unpopular policy was adopted implied that economic reform was becoming politically feasible without endangering democracy. The fact that erstwhile opposition parties adopted economic reform when they came to power implied that a broader tradeoff was achieved by the young southern democracies. To experience a smooth alternation in power was a major sign of the strength of democratic systems, and therefore, the achievement of a significant 'political good.' Stabilization policies are unpopular because they always imply the restriction of economic goods since they are based on curbs of demand and incomes. Despite their unpopularity they became politically feasible for the new governments in the 1980s, because it was becoming clear to electorates that economies were facing an impasse, and also because these governments were no longer under serious threat of a relapse to dictatorial conditions.

Σχόλιο [SDP19]: p.323

Basic indices of economic performance of the three South European economies and the EEC for the period 1980-2004 are shown in Table 8.4.

Table 8.4 Indices of economic performance, 1980-99

	1980-4	1986-9	1989-4	1995-9	2000-4
GDP annual growth rates					
Greece	0.8(%)	2.4(%)	0.8(%)	2.9(%)	4.1(%)
Spain	1.4	4.7	1.6	3.5	2.9
Portugal	1.3	5.8	2.1	3.4	1.1
EEC average	0.9	3.4	1.5	2.4	1.7
Annual growth rates of fixed investment					
Greece	-4.5	1.2	0.4	7.9	7.9
Spain	-1.4	12.9	-0.8	6.8	3.4
¹ Portugal	-1.5	12.0	2.7	7.2	-1.5
EEC average	-0.5	6.2	0.3	4.0	0.9
Consumer price inflation					
Greece	21.9	15.5	16.2	6.4	3.3
Spain	13.3	7.4	5.9	3.1	3.2
Portugal	22.8	13.6	9.6	3.8	3.3
EEC average	9.8	4.2	4.2	2.2	2.2
Annual growth of government consumption					
Greece	3.0	2.8	-0.5	2.2	n.a.
Spain	3.8	6.7	3.7	2.5	n.a.
Portugal	3.7	6.6	4.0	2.3	n.a.
EEC average	1.5	2.0	2.0	1.2	n.a.

Sources: For 1980-4, OECD (19866), Tables 3.1, 4.3, 8.11, and 4.7; for 1986-9, OECD (2001a), Tables 3.1, 4.3, 7.11, and 4.6; for 2000-4, OECD (2004), Tables 2, 5, and 18.

If we seek a general characterization of the period 1980-2004, we notice that it shows an alternation of four phases of high and low economic performance: the early 1980s, 1990s, and 2000s were periods of slowdown or recession, while the late 1980s and 1990s were periods of growth. In this general alternation of economic phases, it is visible that the South

Σχόλιο [SDP20]: p.324

European economies move in step with the EEC—a reflection of the increasing harmonization of their economic movements with the outside world. Theirs could not be considered closed economies in a true sense any longer. Looking more specifically at GDP growth rates and the rates of change in fixed investment (the top two panels of Table 8.4) we note that the early 1980s were a period of dismal performance for the three southern economies, but this was matched by poor EEC-wide performance. Furthermore, Spain and Portugal had instituted stabilization programs during that period, and the restriction on domestic demand that was due to these programs was taking its toll on growth. It is also noted that of the three southern economies, Greece exhibited the worst growth and investment record in the early 1980s, despite the fact that it was the only economy that was engaging at the time in expansionary economic policies. Its stabilization program was instituted in 1985, and it affected its performance in the second half of the decade. In this overall characterization of the early 1980s, we must also note that this was a period of high inflation for all of Europe, but that inflationary conditions were extreme for Greece and Portugal, where annual price level change exceeded 20 percent, but not so extreme in Spain. On the other hand, in this period Spain experienced a big rise in unemployment.¹²

The second half of the 1980s was a period of recovery and economic development. The EEC economies experienced significant growth, a substantial recovery of investment and an equally decisive decline in inflation. At this time, which also coincided with the first postaccession period for the two Iberian countries into the EEC, these two economies exhibited a spectacular recovery and high growth of both GDP and investment. In fact, the Spanish and Portuguese growth rates exceeded considerably the European average and their high investment rates were reminiscent of the boom conditions of the 1960s. One could persuasively argue that the two economies reaped early the benefits of both their internal stabilization efforts and their entry into the EEC. Growth always creates a positive environment for additional economic reform and structural change. It can be surmised that the interval of Iberian growth in the 1980s offered further impetus to economic change and made the necessary policies much more feasible politically than they would have been otherwise. A case in point is tax reform, at which we shall look more closely later. At the general performance level, we also note that consumer price inflation declined significantly in the three economies. In fact, looking at the long-term picture through the 1990s and the early 2000s, at the third panel of Table 8.4, it is clear that a process of convergence of the southern economies to the low inflation levels of the EEC began in the second half of the 1980s and would continue uninterrupted through the end of the period. This has been of course the outcome of strong policies that led to, and finally achieved, monetary union and the single European currency. These policies were to be adopted by all three Southern European countries, which were full-fledged members of the Eurozone at the close of the last century.

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The comparison of performance between the three South European economies shows a remarkable similarity between Spain and Portugal, and a significant differentiation of Greece. In fact, a careful review of the first three panels of Table 8.4 reveals that in terms of GDP growth, growth in investment, and consumer price inflation Greece fared much worse than both the other two countries and the EEC through the period 1980-94. Only in the last subperiods of 1995-2004 does Greek performance improve appreciably. The Greek exception was in part due to circumstance and in part due to policy differences. In the 2000s Greece fared well due to a big investment push motivated by forthcoming Olympic Games, clearly a special factor. The similarity of Spain and Portugal had surely been caused in part by the coincidence of the timing of their stabilization programs and of their accession to the EEC. The difference of Greece had multiple causes that extended in time. In effect, Greek stabilization was greatly delayed and would eventually be successful only in the second half of the 1990s. The stabilization of the 1980s had failed to impose macroeconomic balance and usher in a period of growth in Greece, as had happened with the Iberian economies.

The economic policy of PASOK when it took power in 1981 was not constrained by an ongoing negotiation or an impending accession into the EEC, since that was already an

accomplished fact. Furthermore, a political platform of broad social change that would touch the unprivileged and disenfranchised strata of society was the foundation of PASOK's electoral appeal and its meteoric rise. Early policies were redistributive and expansionary, and rapidly led to significant increases in public spending and deficits. Besides boosting domestic demand however, PASOK also instituted policies for the reform of the 'supply side' of the economy, in the form of promoting large integrated industrial projects, infrastructures, and sectoral policies.¹³ These policies did not prove successful mainly because domestic demand expansion did not feed into sufficient domestic investment, but rather soon led to an external payments crises and exchange rate instability.¹⁴ These conditions undermined the ability of government policy to intervene effectively on the 'supply side' of the economy. More specifically, monetary uncertainty and the risk of devaluation undermined the investment climate, and growing fiscal deficits undermined the potential for public investment initiatives. The contrast to PSOE's policies followed in Spain at the same time is an interesting one. The Spanish socialists also engaged in 'supply-side' policies extensively. However, they combined these with severely restrictive monetary policies and macroeconomic stabilization (see Boix 1998: 107—13). In part, this combination was necessary because of their impending EEC accession. Strict monetary policies were also conceived and implemented in conjunction with the eruption of a major banking crisis in Spain that led to a necessary restructuring of the country's financial system. In contrast with Greece, Spanish policies managed to impose monetary stability and restrain public deficits. These conditions promoted private and public investments, and these in turn became the most important vehicle for successful 'supply-side' reform. Spanish policies clearly benefited from favorable timing since they were already in place and working by the time general economic conditions turned favorable in Europe in the mid-1980s. Thus, they were rewarded by rapid growth in the second half of the 1980s, whereas Greek policies were not.

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After the election of 1985, when the Greek socialists were again returned to power, the government of Andreas Papandreou instituted a formal stabilization policy under the management of Constantine Simitis who took the post of minister of national economy. The policy was initially successful but was abandoned in 1987. Sensing erosion in political support, the government aborted stabilization too soon, changed ministers of national economy, and refashioned once again an expansionary policy until the next election of 1989. The early abandonment of stabilization essentially meant that the economy and society had to absorb the costs and the pains of restrictive demand measures, without having reached the point of reaping the benefits of lower inflation and higher investment and growth rates. Thus, the Greek economy was destined to finish the decade of the 1980s with high inflation, high deficits, and a public debt looming higher than those of the other two countries of the European south (see Thomadakis and Seremetis 1992: 209-23). Nevertheless, the failure of macro-economic stabilization did not cancel other efforts for structural reform, and, among other policies, a major liberalization of the financial system was initiated at the end of the tenure of the socialist government (see Hellenic Banks Association 1987). This would prove to have long-term effects on the economy in the ensuing period.

A serious economic slowdown in the first years of the 1990s, followed by substantial and sustained recovery in the remaining years of the last decade of the twentieth century, shows a general pattern of convergence in economic performance of the southern countries vis-à-vis the EEC. GDP growth rates, rates of change in investment and inflation rates attained comparable levels and changed in the same direction overtime. Greece followed this pattern with a delay, but it is evident in the data for the period 1995-2004, that the Greek economy finally succeeded in achieving stabilization and macroeconomic adjustment, while at the same time expanding with an above average growth rate. Thus, on the whole, the three young democracies of the European South achieved a remarkable convergence to the EU average, in terms of economic movement and performance. Let us now turn our attention to whether this convergence also extended to basic fiscal structures.

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The Comparative Evolution of Fiscal Structures

The economic phases of the last two decades of the twentieth century found the three Southern European economies on a path of convergence with the other members of the European Community in terms of overall economic performance. Our observations from the earlier period of transition to democracy had shown that fiscal expenditure had been growing at a rapid pace, outstripping public revenues. It is now important to examine how the imbalance between fiscal expenditure and revenue was corrected, so that in the end all three economies were able to obtain membership in the European Monetary Union and to take part in the common currency project.

In terms of broad fiscal data, the most meaningful summary statement can be obtained from OECD data, which consistently record, over long periods of time, current disbursements and current receipts of government.¹⁵ These are shown as percent of GDP in Table 8.5, for the three South European economies and the EEC average respectively.

The main observations from Table 8.5 are the following. First, there was continued growth in the percent of GDP taken up by government disbursements. In the case of Spain and Greece the growth of GDP percentages was quite dramatic over the period covered, whereas in Portugal growth was moderate and more in line with the milder trend shown for EEC countries as a whole. Given the lower starting point of South European economies, these differential developments imply that Greece and Spain converged to the average European level of expenditure faster than Portugal. Second, a similar pattern appeared in the development of current receipts of governments, as a percentage of GDP of the respective countries. Receipts grew in step with disbursements, with more dramatic changes in the cases of Greece and Spain. It should be noted that the relative equilibration of receipts and disbursements occurred in Greece later than in the other countries; this is consistent with our earlier explanation about the delay in Greek adjustment and successful stabilization. In fact, during the period of the economic downturn in the early 1990s, the two other South European economies had managed to establish basic balance, according to the estimates of Table 8.5. The difference between current disbursements and current receipts in Spain and Portugal did not exceed 2 percentage points of GDP in 1990-4, whereas in Greece, the same difference appears to have amounted to almost 8 percentage points of GDP. This is indicative of the fact that even by the mid-1990s Greece had not achieved fiscal balance and macroeconomic adjustment. These would be attained only in the later part of the 1990s.

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Table 8.5 Fiscal structures (percentages of GDP)

	1980-4	1986-9	1989-94	1995-9
Total government outlays				
Greece	36.4	44.9	47.7	52.2
Spain	36.8	41.4	45.8	45.3
Portugal	41.0	40.2	43.3	42.5
EEC average	47.7	49.5	50.0	49.0
Current disbursements of government				
Greece	36.1	42.0	42.5	49.3
Spain	32.5	36.1	40.5	41.3
Portugal	36.5	36.5	39.7	38.7
EEC average	43.8	45.2	49.1	45.7
Social security transfers				
Greece	12.1	15.1	14.6	15.4
Spain	15.5	15.5	17.3	17.2
Portugal	11.1	10.5	12.6	11.7
EEC average	17.2	15.8	17.4	17.2
Current receipts of government				
Greece	32.1	34.5	34.7	46.9
Spain	31.8	36.2	39.7	38.7
Portugal	35.0	35.0	38.1	37.6
EEC average	41.9	43.4	43.5	44.1

Sources: For 1980-9, OECD (19916), Tables 6.5, 6.4, 6.3, and 6.6; for 1990-9, OECD (2001a), Tables 6.5, 6.4, 6.3, and 6.6.

The measures of Table 8.5 are indicative of trends, but not very accurate descriptors of fiscal structures. Current receipts of government include not only taxes and social security contributions but also items such as receipts from sale of assets or state interests to private parties, revenues from profits and other nontax items. A focus on tax structures proper is now in order since this reflects more permanent **change**, as well as a most important aspect of economic policy. Tax policy has, as we have argued before, both economic and political implications. In the context of the economic consolidation of the three economies of the European south, tax policy was an area of great priority and political sensitivity. In all three economies, taxes had to be increased over time in order to maintain earlier increases in public expenditure which, in many cases, were necessary in the new democratic order that was constructed in the three societies. In all three societies, the legacy of authoritarian regimes made tax imposition and tax collection a more difficult and sensitive issue than it would normally be in the institutional context of northern European economies. Finally, in all three economies there was a common step in the imposition and enforcement of the VAT, as a result of their accession to the European Community. This important tax has played an important role in the convergence of tax structures of the **southern** three to the common European standard. Table 8.6 presents tax receipts and social security contributions as a percentage of GDP for selected years, starting from 1980.

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The data in Table 8.6 reveal two noteworthy features. The first is that the three South European economies have made very significant progress in terms of taxation over the interval 1980-2002. From less than a quarter of GDP, their total tax receipts rose to a third of GDP over that period. This was no mean feat. Such a magnitude of growth testifies to the successful broadening of the tax base in those societies. The second feature is that the three converged among themselves and also converged toward the EEC average, although still remaining below it by about 5 percentage points of GDP. In 1980, the difference between the southern economies and the EEC average had exceeded 11 percentage points of GDP. Thus, it is clear without deeper analysis that politics and policies in the south were successful in achieving a very remarkable improvement and convergence of fiscal receipts to the European norm. More importantly, this success signified that the political system was capable of

responding to the challenge of increased public expenditure in a fashion that maintained stability in the macro-economic situation of the southern economies. The broadening of the tax base was accompanied in many cases, in Spain and Greece notably, by public campaigns against tax fraud and evasion. These contributed to the improvement of tax compliance, which is a basic underpinning of the viability of any fiscal system.

Table 8.6 General composition of receipts (percentages of GDP), 1980-2002

	1980	1985	1990	1995	2000	2001	2002
Greece							
Total	24.0	28.6	29.4	32.4	38.2	36.6	35.0
Tax revenues	16.1	18.5	20.5	21.9	26.4	24.9	24.1
Social security	7.9	10.2	8.9	10.5	11.8	11.7	11.8
Workers	3.5	4.5	4.4	4.3	4.6	4.8	4.6
Employers	3.5	4.3	4.4	4.8	5.5	5.5	5.6
Spain							
Total	22.9	27.9	33.0	32.8	35.2	35.0	35.6
Tax revenues	11.8	16.2	21.3	21.0	22.9	22.5	23.0
Social security	11.1	11.4	11.7	11.9	12.3	12.5	12.6
Workers	2.5	2.0	1.9	1.9	2.0	2.1	2.0
Employers	8.7	8.6	8.4	8.2	8.6	8.6	8.9
Portugal							
Total	24.6	27.1	29.6	33.6	36.4	35.6	33.9
Tax revenues	17.3	20.1	21.6	23.5	25.5	24.6	24.7
Social security	7.3	7.0	8.0	10.1	10.9	11.0	9.2
Workers	2.8	2.7	2.9	3.3	3.4	3.5	n.a.
Employers	4.4	4.0	4.8	6.3	7.0	7.0	n.a.
EEC 15							
Total	35.8	38.6	39.2	40.3	41.8	41.2	40.6
Tax revenues	25.6	27.7	28.3	28.5	30.3	29.7	29.2
Social security	10.3	11.1	11.1	11.8	11.5	11.6	11.4
Workers	3.0	3.5	3.6	4.1	3.8	3.7	3.7
Employers	6.5	6.6	6.6	6.6	6.7	6.8	6.8

Source: OECD (2000), Tables 3, 4, 14, 17, and 18; OECD (2004), Tables 3, 4, 14, 17, and 18.

The breakdown of total receipts into taxes proper and social security contributions indicates certain variations among countries. These variations are not very significant except in one respect: social security receipts appear to have been structurally lowest in Portugal and highest in Spain, with Greece furnishing the middle case. The difference between the two extreme cases amounts to about 2.5 percentage points of GDP. This may reflect history as well as politics. Spain has experienced over the interval discussed here the highest unemployment rates and this has made it politically expedient and necessary to lean heavily on social security contributions.¹⁶ Furthermore, practically throughout the observed period, the governing political power in Spain were the socialists who had since the early 1980s engaged in active reforms of the social security system. Thus, Spain's social security receipts appear to have converged exactly to the European average by the mid-1990s, overtaking in the 2000s, whereas those of Greece and Portugal came very close or remained somewhat below that average. On the obverse side of the same observation, Portugal's tax receipts proper (excluding social security contributions) were a somewhat higher percentage of GDP than in the other two countries, implying that more policy emphasis was placed on taxation than social security funds in that country.

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An additional point of divergence among the three countries relates to the allocation of social security tax burdens between employees and employers. In this respect the differences are so significant that they can be considered spectacular. Spain, at one extreme, has placed most of the burden of social security taxes on employers. Consistently through the period shown in Table 8.6, employers were carrying more than four times the social security

tax burden than employees. Greece at the other extreme has consistently imposed a higher burden on employees than on employers. This changed only in the years 2000 but the difference with the other two remained. In other words, this is contrary to what is observed not only in Spain and Portugal, but also in the EEC average, where in 1998 the burden on employers appeared to be double that imposed on employees. The Greek difference is notable because it probably testifies to the power of employers who have apparently been able to overcome what we would consider normal allocative policies of social security burdens. More generally, the allocation of social security tax burdens makes up an important element of progressivity in a country's tax system. In most cases the allocation places more of a burden on employers, and this constitutes a *prima facie* progressive nature of the system. In the case of Greece, the unorthodox allocation in favor of employers constitutes a significant element of regressivity in the tax system, that has been consistently present in the country's social security regime. Although it is not possible to offer an accurate measure of regressivity arising from this feature (it is clear that, compared to the other South European economies and to the European average, the Greek system is less progressive).

We can now turn to more precise comparative evidence about the composition of tax receipts proper. A three-way categorization of taxes is helpful. One broad category is taxes on income, which includes both personal and corporate income and constitutes what we normally consider direct taxation.¹⁷ A second broad category includes taxes on goods and services, which constitutes what we normally consider indirect taxation. A third category includes property taxes. Table 8.7 presents percentage composition of tax receipts, excluding social security taxes, over the interval 1980-2002 for the three southern economies and the European average.¹⁸

The estimates of Table 8.7 are quite revealing as they show both change over time and significant divergence among the three Southern European economies, as well as between them and the European average. Let us first focus on observed changes that take place over time. The composition of tax receipts in the EU as a whole has been remarkably stable over the 1980s, 1990s, and early 2000s. About half of total receipts have come from direct taxes, about 44 percent from indirect taxes and the rest from property taxes. This very stable European structure has persisted through several phases of the economic cycle and this makes its stability all the more remarkable, testifying to broader institutional stability. In the three economies of the European south, in contrast, tax composition has been changing significantly. The change was not linear in most cases, and this is a significant indication of the sensitivity of change to shifts in the economic cycle, but probably also in the political cycle. Furthermore, 1985 is probably the most critical year in the institutional sense, since it is in or near that time that all three South European economies moved to implement the VAT. As a result, post-1985 trends are the important elements to observe here, since a major tax harmonization took place in the south of Europe. The fact that tax composition changed in the European south reflected both the change in the form of indirect taxation via the imposition of the VAT, and the effort that was clearly underway in each of these countries to increase tax receipts as a whole and achieve fiscal balance.

Σχόλιο [SDP28]: p.332

Table 8.7 Tax composition (percentage of tax revenues excluding social security)

	1980	1985	1990	1995	1998	2000-2
Spain						
Taxes on income	50.6	44.6	47.4	45.8	43.5	44.2
Goods and services	40.3	48.9	43.9	44.8	45.4	45.6
Taxes on property	8.9	5.9	8.5	8.6	9.3	10.2
Portugal						
Taxes on income	27.9	34.7	35.3	35.9	38.7	39.4
Goods and services	63.7	57.8	60.7	61.6	55.4	55.7
Taxes on property	2.0	2.6	3.7	3.4	3.9	4.9
Greece						
Taxes on income	28.9	27.2	28.5	32.9	33.5*	37.6
Goods and services	61.4	66.3	63.8	61.0	60.0*	54.4
Taxes on property	6.9	4.2	6.6	4.9	5.6*	8.0
EEC 15						
Taxes on income	47.6	47.8	47.8	43.4	48.7	50.2
Goods and services	43.7	44.3	43.9	39.8	41.8	42.9
Taxes on property	5.9	5.5	5.9	6.1	6.5	7.0

1997 data for Greece. Source: OECD (2000), Tables 9, 23, and 25; OECD (2004), Tables 9, 23, and 25.

The direction of change in the composition of taxes is contradictory in the three southern economies. In Spain, the share of direct taxes as a percentage of total tax receipts declined in favor of indirect and property taxes, especially in the 1990s to increase somewhat in the early 2000s. In Portugal and Greece, by way of comparison, there was an increasing reliance on direct taxation during this same period. But the most notable feature of the data shown in Table 8.7 is that Spain was far ahead of the other two countries in terms of how closely its tax structure resembled the European average, with respect to its heavier reliance on direct taxes in particular. If we consider the degree of reliance on direct taxation as a preliminary indicator of progressivity in a country's tax system, it is clear that Spain appears the most progressive and Greece the most regressive of the three Southern European states, with Portugal occupying the middle position. Greece's delay in increasing the role of direct taxes, despite the 'catch-up' that is apparent in the late 1990s and early 2000s, was due mainly to the later overall adjustment of the Greek economy that was discussed above. More specifically, it was due to the fact that Greece did not partake in the growth phase of the late 1980s as fully and as successfully as the two other South European economies. It was during that phase that Spain, in particular, managed to bring about significant changes both in legal and in enforcement structures of their respective tax systems, especially the broadening of the tax base and the fight against tax fraud practices (see Boix 1998: 113-15).

The overall picture that emerges from the period of economic consolidation of the three southern economies is a very revealing one. Tax receipts have increased and have corrected the structural imbalance that marred the fiscal condition of the three economies during and after their democratic transition. The increase of tax revenues achieved spectacular results and brought the three economies into close convergence among themselves and to average European structures. They thus were able to present appropriate macroeconomic alignment with the criteria required for EMU participation.

The uniformity and convergence of fiscal conditions that are apparent in the aggregate do not extend to a more detailed level, however. Both the structure of social security revenue and the composition of tax revenues proper exhibit very significant divergences among the southern economies and between them and the European average. Spain appears to have attained the most progressive system of tax receipts, closely resembling the European norm. On the other hand Portugal and Greece appear to lag behind, with Greece implementing a more regressive system both in taxation proper and in social security

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contributions. The contrast between Spain and Greece is all the more notable since both countries have had socialist governments in power during most of the interval observed and discussed here.

Whereas overall adjustment and aggregate convergence have been necessary for European participation, the lack of uniformity in more particular aspects of the tax and social security systems of the three southern economies testifies to the truth of the assertion that 'politics matter/ both in terms of the general impact of democratic political processes, and in terms of party ideologies and strategies. The three economies of the south of Europe followed particular paths on their way to aggregate adjustment, and each faced specific constraints, both political and economic. There was also a different process of learning that was unwinding over that period, as policymakers had to respond to complex conditions involving both European and internal strictures and requirements. For example, the behavior of Greek socialists, after the defeat of their conservative opponents in 1993, was clearly influenced by the earlier failure of their unfinished stabilization effort of the mid-1980s. The behavior of Spanish socialists, in contrast, was affected by the fact that the economic boom of the mid-1980s improved greatly the degrees of freedom of their economic policy, and enabled them to continue with economic modernization, despite the dissolution of their implicit alliance with unionist labor that had supported their earlier policy efforts.

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Concluding Observations

Over the last quarter of the twentieth century, the three states of Southern Europe—Greece, Portugal, and Spain—achieved a major and complex historical feat. They established and maintained stable democracies, entered the EU and later joined the monetary zone of the Euro, achieved macroeconomic adjustment and enforced fiscal equilibrium, and shared the opportunities and the benefits of European growth. These achievements furnish an important historical example of successful integration of less developed economies into a system of more developed ones. The most significant feature of this integration has been the strong tendency for convergence between the less and the more developed parts of the integrating system. As a historical example this is notable because it counters many opposite cases of integration where divergence rather than convergence of the integrating parts has been noted. Furthermore, the success of European integration in the case of the three southern economies has undoubtedly been an inspiration for the policy for enlargement of the EU, which by the spring of 2004 extended to almost all of Eastern Europe. If integration with convergence is repeated in the broader field of this new and more ambitious enlargement, Europe will truly lay claim to a historic achievement of development through extensive integration, the successive opening of markets, and the partial subjugation of national to supranational economic policy. In fact, this is precisely the vision that makes supranational economic policy in Europe all the more important and burdens it with complex duties.

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Democratization has provided a strong and fundamental impetus in the achievements of the three southern economies and societies. The drive to deliver economic well-being and wide participation in the benefits of growth was a strong corollary of the establishment of democratic order. At the same time, the drive to join Europe, and to converge to its norms, became an integral part of the vision of central political players that brought about the transition and the consolidation of democracy in the three southern countries. The two elements of the democratic vision—social benefits from growth and European convergence—worked their way through domestic politics so as to produce a uniform result in the three southern states: an increase in social spending combined with an increase in tax receipts that were more progressively structured. In this fashion fiscal balance and macroeconomic equilibrium were achieved and provided the basis for admission of the southern economies into the eurozone.

It certainly must be emphasized that the success of this dual set of aspirations was predicated on two conditions. On the one hand, the significant periods of economic growth for Europe as a whole during the late 1980s and the 1990s amplified the degrees of freedom for

economic reform and helped to combine prudent macroeconomic management with structural change in the southern countries. On the other, change in the south passed through an inevitable growth of the economic role and power of the state. The successful democratization-cum-integration could most probably not occur under any other conditions. The southern states were traditionally autocratic but economically weak, and this was a part of the dictatorial legacy that had to be reversed in both its dimensions: the state had to be transformed to a democratic but economically strong entity. And so it was. Part and parcel of European integration of course has been the subsequent transmission of some economic policymaking powers to supranational entities (European Central Bank, European Commission). Yet, state functions as a whole increased in the south, changing at the same time their character as compared to the dictatorial past.

Convergence does not mean uniformity. In the south of Europe each country followed its very particular path both in terms of economic change and in terms of domestic politics. The initial conditions right after democratization were very different in the three countries. The terms of political competition and cooperation within their nascent democracies were also quite different during both the transition and the consolidation phases of their democratic orders. Although they all achieved similar results, the underlying economic structures were not the same either at the start or at the end of the process. Tax structures and structures of social spending are a case in point. Domestic politics differed greatly in terms of content, speed and even orientation of reforms, although in all cases the overall goals were similar. Reform is a continuous challenge. The differences in economic structures and the ever renewable variation of domestic politics promise to fuel a differentiated path of reform for the three southern democracies of Europe in the future as well.

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Notes

1. The comparison of average inflation rates over long intervals masks in this case a sudden shift in consumer prices that took place in 1973, and went on in following years. We come back to this point below. Taking this into consideration, we cannot make any stronger inferences about the effects of inflation.
2. See Gunther 1980 and 1996 for informed analyses of Spanish policymaking both before and after the Franco years.
3. This is the net contribution of government to aggregate demand, includes salaries and purchases of goods and services, but excludes transfers (social security pensions, interest).
4. The Spanish state administration maintained a degree of continuity during the democratic transition, in contrast to the chaotic condition experienced in neighboring Portugal. In Greece also no wholesale purge of the public administration was undertaken. See Gunther 1996: 169-70.
5. In the election of 1977 Nea Demokratia, the conservative party, led by Constantine Karamanlis obtained an absolute parliamentary majority with 42.9 percent of the vote. PASOK, the socialist party, led by Papandreou made an impressive electoral appearance with 25.3 percent of the vote and took the place of main opposition.
6. The pacts of Moncloa are an example of 'concerted' political agreement among major players for the exercise of agreed macroeconomic and collective bargaining restraint. Besides its obvious significance for economic stability, this type of consensus building was an important building block in democratic legitimacy and a radical departure from corporatist practices of the Francoist past, as Gunther points out (1996:172—3). There is no instance of this type of policy consensus in the other two South European countries, during the period of democratization.
7. The moderate-conservative governments that managed successfully the democratic transition in Greece did not engage in serious economic reform but sought to avoid social conflicts that could undermine political commitment to democracy. This feature is shared by the policies of moderate-conservative post-Franco governments in Spain. The obvious priority in both countries was to build a viable democracy and worry later about a viable economy. Also see Maravall 1997: 78-9.
8. The Table switches to observation of particular 'signal years' because of data limitations in the OECD bases available. Expenditure and tax data are not uniformly reported. No obvious distortions have been detected from this change however.
9. See Castles, in this volume, for an extensive comparative analysis of social spending. His findings include at least partial evidence that democratization furnished an important impetus to social spending.
10. A more extensive discussion of economic performance follows in Table 4.

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11. For a discussion of political conditions and electoral influences on the choices of economic policy in the three countries at that time see Maravall 1997, Chapter 3.
12. As Maravall notes official unemployment figures in Spain rose from 8.6 to 16.2 percent between 1979 and 1982. See Maravall 1997: 85.
13. A change of leadership in the Ministry of National Economy in mid-1982 altered the pure demand policies of the early months. It brought the team of Gerasimos Arsenis and Constantine Vaitsos as minister and deputy minister, respectively, to the helm of economic policy. They instituted a mix of moderate demand and ambitious supply side policies. Vaitsos, a prominent developmental economist, headed the effort to model and implement sectoral policies.
14. The drachma was devalued in 1983 and again in 1985.
15. The terminology 'disbursements' and 'receipts' is based on OECD nomenclature in historical statistics. These categories differ somewhat from 'expenditure' and 'revenue', as the latter refer as a rule to more narrow measures. For example, receipts include nontax items. As trends are the important elements in the Table, we follow OECD nomenclature here.
16. Also see the commentary on this by Castles in this volume.
17. The OECD data do not allow a full decomposition of income taxation between personal and corporate income on all countries and for the entire period. Thus, the aggregate category of total income taxation is maintained in the Table. Some comments on the decomposition in the more recent periods for which there is full data are in the text that follows.
18. The average shown in the Table represents the average of the 15 member states of the EU.