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5 ways to transform Greece's economy now

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Greece's problems aren't all about debt. They're about competitiveness, and changing the arcane rules in areas from the cruise industry to pharmaceuticals would help it reboot its economy.


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FORTUNE -- The searing images from Athens -- the streets choked with rioters, stately buildings and Starbucks' ablaze -- are masking a drive to liberate markets that's unlike anything any nation has attempted to do in decades. The platform is being pushed hard by the new Papademos administration, under intense pressure from the "troika," the IMF, EU and European Central Bank. Greece will need to rapidly enact the historic list of reforms to obtain the latest grant of $170 billion from the troika, and avoid a disastrous default when its next wave of bonds come due in mid-March.

These reforms aren't just necessary to prevent bankruptcy. They're absolutely essential if Greece is to once again grow and prosper, conditions that are impossible with its current inflated level of wages and highly restricted, cartelized, uncompetitive markets.

Greece's principal problem is that it's been depending for years on selling more and more home-

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grown goods and services that don't face international competition -- houses, haircuts, insurance policies -- to its own people. That model appeared to work when Greeks experienced a consumer credit boom from 2001 to 2008. But the explosion in domestic demand meant that wages soared, making Greece's exports too pricey on international markets. At the same time, its domestically produced appliances and electronics couldn't compete with cheaper imports from Germany or the Netherlands. Greece also did nothing to overhaul the monopolistic practices in tourism and trucking that further curbed exports.

As a member of the eurozone, Greece can't devalue its currency to restore its competitiveness and boost exports. To grow again, Greece needs to both lower wages dramatically and enhance productivity by de-regulating markets at a wrenching pace.

It's a grinding, politically treacherous task. Still, the number and scope of reforms that Greece has either passed, or promises to pass, in the last few months is indeed impressive.

Let's examine five new measures that would totally transform the Greek economy.

The cruise industry

Its island jewels and wonders from antiquity make tourism Greece's number one industry, accounting for 15% of GDP. Greece should be one of the world's foremost destinations for cruise ships. But highly restrictive laws have long discouraged foreign tour operators such as Carnival and Princess from visiting Greece.

For decades, the law required that all foreign operators needed to hire a high percentage of Greek sailors on their crews in order to start or end a trip at a Greek port. It's remarkable that the EU didn't attack this highly anti-competitive provision, since it also applied to French, Spanish and all other players in the European Community. As a result, the world's cruise lines used Turkey or Israel as home ports. Tourists flew to Istanbul or Haifa instead of Athens, and rewarded their hotels and vendors.

In 2010, under orders from the troika, the Greek government enacted a new law that promised reform, but failed to deliver in practice. The measure finally lifted the requirement for hiring Greek sailors for EU carriers, but imposed a stiff tax on U.S., Canadian and all other non-EU companies to benefit the sailors' retirement fund. It also required cruise lines to sign a three-year contract guaranteeing visits to Greek ports.

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Not a single cruise line entered the market under that law. But now, the new government has pledged to enact a measure that removes both the tax and the contract requirement for non-EU carriers. It's now on the docket for the current parliament. "The new law promises to make ports such as Piraeus a major attraction for the big cruise operators," says Nicos Vernicos, head of the International Chamber of Commerce in Greece. Watch this law closely: Its passage would be a crucial bellwether for reform.

The trucking industry

The shockingly high cost of road transport is socking both Greek exports and domestic production. To operate a trucking fleet, companies need a license for each truck, and no new ones have been granted since the 1970s. "In 40 years, Greece's international trade has tripled, and the number of trucks is frozen," says Miranda Xafa, a leading Greek economist. As a result, trucks are in short supply, so manufacturers need to pay inflated prices to move merchandise within Greece, or to foreign markets. The licenses do get sold, but only at huge prices, once again ensuring that truckers will charge a king's ransom recoup their heavy investment.

Greeks buy cauliflower from Belgium because it's so expensive to transport inside within their own borders. It costs less to move an apartment full of furniture from Brussels to Athens with a Belgian trucker than to ship the same furniture from an Athens warehouse to the new lodging a few miles away. Trucks transporting electronics from Athens to Thessaloniki were barred from returning with a new load.

In 2010, the parliament passed a law enabling the government to issue new licenses at minimal cost. But the reform was delayed for three years -- reminiscent of the attempt at first cruise ship "reform" -- leading to questions over whether it would really happen. Early this year, the parliament eliminated the transition period, and fully opened the trucking market as of January. Unless Greece retreats, its shipment of everything from olive oil to appliances will cost far less to foreign buyers, and its vegetables and other produce will reach new markets across Greece.

Pharmaceuticals

For several decades, the Greek economy has been rife with price controls that hammered consumers, and removed all incentive for the coddled industries to improve productivity. A notable example is pharmaceuticals. The government guaranteed pharmacies a 35% markup on all drugs. So a patented, $200 a month heart medicine got $70 tacked onto the retail price. "The incentive to over-prescribe was immense," says Xafa. "It explains why Greece has the highest level of pharmaceutical consumption per capita in the EU."

Under a new law, pharmacies are limited to imposing a margin of 15% on inexpensive drugs, and far less on expensive therapies. On average, the markups should fall from the old 35% to well under 15% on average, a major victory for consumers.

Resort development

To lovers of Greece, it's a mystery why this island idyll isn't a retirement destination on the scale of Spain or Portugal. By rights, Greece should be the Florida of Europe. Once again, it's rigid laws that suffocate the market. In Greece, areas outside of cities do not have zoning laws. That doesn't mean you can build freely on islands or in rural areas. On the contrary, development is severely restricted. Only a single law allows for master plan development, and it requires that the villas and homes be constructed around a major hotel.

The law also prevents the developer from selling homes or villas; only rentals are allowed. For example, golf course developments are effectively barred. Incredibly, the entire country offers only a half-a-dozen courses.

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A new law provides two improvements. First, it reduces the requirement of two environmental impact statements to just one, virtually cutting the approval time in half, from two years to a bit over twelve months. Second, it now allows developers to sell many of the apartments and homes in their resorts, instead of merely renting them out. That change alone could make Greece a prime destination for retirees.

But the measure still doesn't go far enough. Developers are pushing for more reforms. "The laws should change to allow development around golf courses and marinas without necessarily building more hotels," says Miltos Kambourides, managing partner of Dolphin Capital, an international luxury resort developer with several projects in Greece. If the thaw continues, it will stir an industry with giant potential.

The labor market

The labor measures enacted this month are the most important reforms of all. In the past, nothing hampered Greece's competitiveness more severely than its multi-tiered system for setting wages. Until recently, the government and the unions negotiated a new "minimum wage" annually, mandating that the lowest-paid employees get a raise of, say, 5%.

In practice, the deal didn't apply to just the bottom level. It set a floor on wages for workers in all industries, up and down the pay scale. Then, a second round of negotiations would occur for each industry, with the 5% national agreement as a minimum raise. So the department store employees might get an extra 2%. Only then would the individual companies engage their unions. Those company-wide agreements would add another couple of points. So raises in the prosperous 2000 to 2008 years could easily come to 9% or 10% annually.

The three-level system guaranteed that pay rose faster than inflation. That caused Greek goods to become more overpriced, year after year, than competing products from Germany, which held wages in check. If one factor is responsible for the disaster in the eurozone, it's the rigid wage policies not just in Greece, but the extremely similar systems in Italy, Spain and Portugal.

Today, unemployment in Greece stands at 21%. Wages are still so high that many employers pay workers cash, off the books, to avoid social security taxes. Incredibly, a raise of 2.5% was scheduled for July at the national level. But this month, in its most decisive move to date, the government dismantled the pay elevator. It passed a 22% decrease in the minimum wage for most workers, and a 32% drop from employees under the age of 24.

The change should produce a reverse ripple effect lowering salaries at all levels. "Greece is finally breaking the spiral," says Michael Massourakis, an economist at Alpha Bank in Athens. "This could make labor markets far more efficient." In effect, the new law allows employers to negotiate strictly at the company level, instead of starting with a big, mandated wage increase before they even start talking to their own workers. The rub: The new system applies for three years. The possibility that Greece will return to the old system in 2015 dampens the significance of this historic reform.

In conclusion, it's clear that Greece is only embracing these widely reviled reforms under intense pressure. It may indeed choose the route of exiting the euro over the pain of staying the course. But after two years of fiddling, it's finally making the right moves. The Greek tragedy is that it may be too late.