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Task Force on
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EMU and Greece

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The opinions expressed are those of the author, and do not necessarily reflect the position of the European Parliament

Although Greece is making remarkable progress towards economic convergence, it remains the only EU country that does not satisfy any of the Maastricht criteria.

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Introduction

On the 25th March the Commission and the European Monetary Institute published their separate reports on progress towards meeting the convergence criteria for Economic and Monetary Union. In addition, the Commission published its Recommendation on which Member States had qualified to participate in the Single Currency on 1st January 1999. Its assessment was that eleven countries met the criteria: Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal and Spain. Denmark and the UK had met the criteria, but had exercised their right to "opt out" for the time being.

This Recommendation now has to be confirmed by the Council of Economic and Finance Ministers (ECOFIN); by the European Parliament; and, for final decision, by the European Council of Heads of State and Government on 2nd May.

*

Greece is not one of the countries identified by the Commission as having met the Maastricht convergence criteria for membership of the euro area on 1st. January 1999. Accordingly, it will on that date become a "Member State with a derogation" under Article 109k of the Treaty.

The considerable progress made in recent years, however, together with the formal adherence of the Greek drachma to the EMS Exchange Rate Mechanism on 16th. March 1998, mean that membership of the Single Currency could take place within two or three years. The Greek Finance minister, Mr Yiannos Papandoniou, has set a target for the Greek economy of full EMU participation on the 1st of January 2001.

Preparations for EMU membership by Greece are, indeed, already well under way. Under the supervision of the Greek Ministry of National Economy and Finance, a National Coordination Committee for the euro is being formed with the participation of members of several Ministries and the Central Bank of Greece. Another Committee is being created to prepare for the introduction of the euro in the private sector, with the participation of representatives of the Federation of Greek Industries (FGI) and the Greek General Confederation of Labour (GGCL).

Finally, public support for Greek membership of EMU in rising, despite some dissatisfaction with the strict economic policies pursued by the government in order to meet the convergence criteria. Opinion polls show some 65% in favour and only some 25% against.

Fulfilment of the Criteria

Table 1 : Convergence criteria for Greece

	Inflation (%, HICP basis) (***Reference value 2.7%)***	**Budget Deficit as % of GDP** ***(Reference value 3%)***	**Public Debt as % of GDP** ***(Reference value 60%)***	**Long-term interest rates (%) §** ***(Reference value 7.8%)***
1993	13.8	13.8	111.6	23.3
1994	10.8	10	109.3	20.8
1995	9.3	10.3	110.1	17.4
1996	7.9	7.5	111.6	14.4
1997	5.2*	4.0	108.7	9.8*
1998 (forecast)	4.5	2.2	107.7	

** Reference period February 1997 to January 1998*
§ But note is appended to Commission table: "For Greece data are not comparable"
Source: Commission and EMI Reports, March 1998

a) Inflation

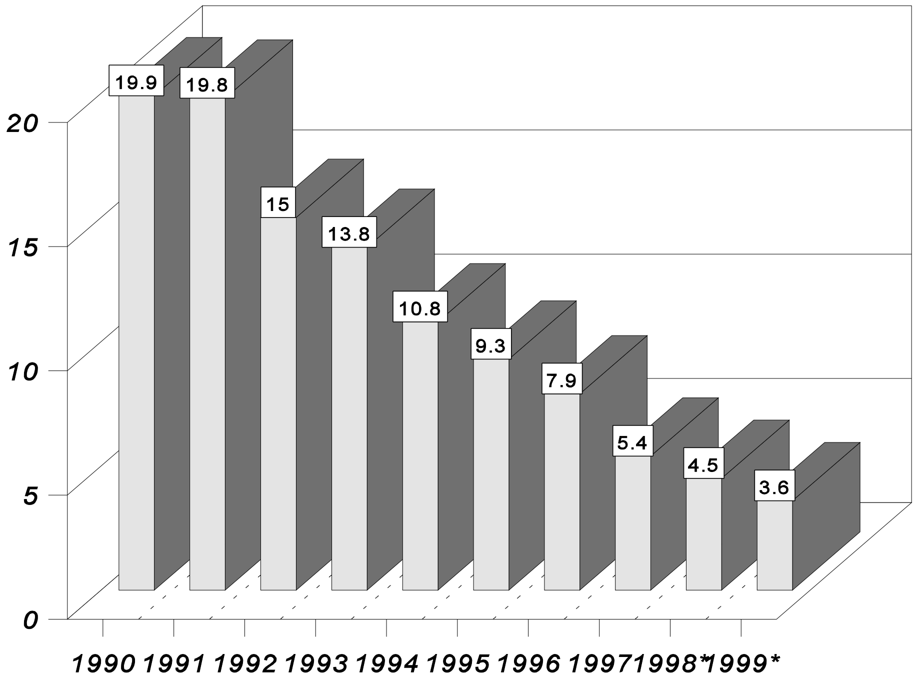
For the first time in the 25 years since 1973, the Greek inflation rate fell to 4.7% in October 1997. The average over the reference period of February 1997 to January 1998 was 5.2%, still 2.5% above the benchmark set by the Treaty (1.5 percentage points above the average set by the three best-performing countries). The rate is, however, still falling steadily.

The reduction of inflation in Greece has been possible thanks to a number of elements :

- The restrictive policy on money supply followed by the Central Bank of Greece, along with the exchange rate policy of a "hard" drachma.
- Adjustments in fiscal policy. The tax base was broadened and tax evasion was fought.
- Structural changes in the labour market, with the slowing of the increase rate of the labour
  cost per product unit from 9.7% to 7.2% in 1997.
- Liberalization of financial markets.
- The recession in 1993 which made possible the emergence of a negative output gap.

The government´s target is now to reduce the inflation rate to below 3% within the next couple of years in the context of Greece's convergence programme.

Chart 1 : Inflation (1990-1999)



** = estimates* *Source: EMI*

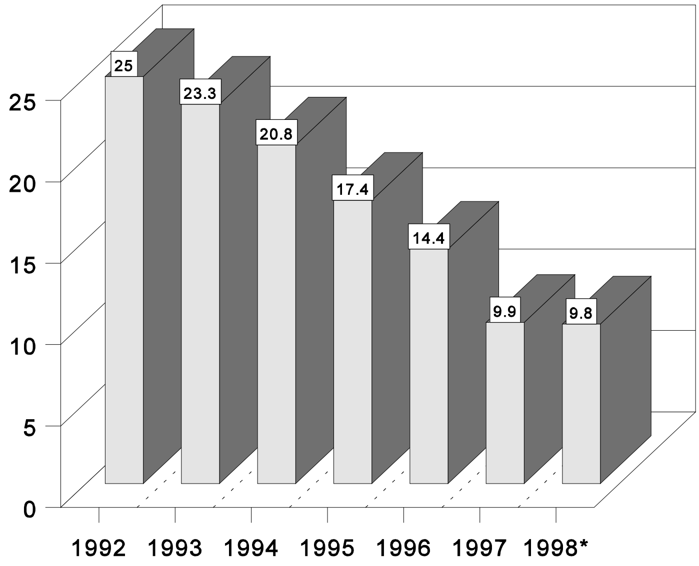
b) Long-term interest rates

Long-term interest rates have been falling during the 1990s. This fall was due to the decline in the inflation differential and the relative stability of the drachma's exchange rate and the recent improvement in the country's fiscal position.

Nonetheless, Greece is still above the reference value for joining the single currency, with 9.8% instead of the 7.8% required.

Although there has been a substantial reduction of interest rates over the last few years, as a result of the lower inflation rate and the greater credibility of the hard drachma policy, interest rates in Greece have been consistently at high levels in comparison with those of the other EU countries.

In September 1997 the interest rate for one-year Treasury Bills was only 9.5% while a few months later, at the auction on the 8th of December 1997, it was on average 11.3%. In January 1998 the interest rate of one-year Treasury Bills still was 11.38%, but at the auction on the 3rd of February 1998 had increased to 12.4%.



It is estimated that the interest rate for home loans in the euro area will be about 7.5% when the single European currency comes into force.

Chart 2 : Long-term interest rates

** January 1998*
Source: EMI Report March 1998

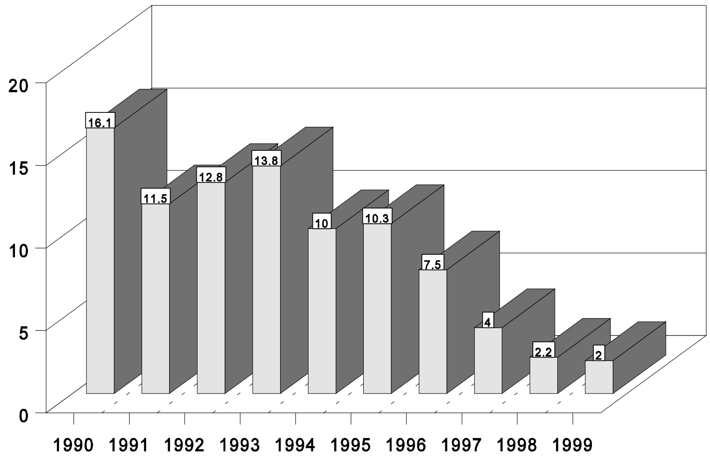
c) Budget deficit as a percentage of GDP

Greece's public finances have been dominated by adverse trends in the past and only in recent years have effective policies been adopted, aimed at reversing these trends and restoring sustainability.

Since standing at 13.8% of GDP in 1993, the public deficit has declined year by year to stand at

4.0%of GDP in 1997.Government total expenditure increased during the 1991-1993 period, because of a steep increase in interest payments as a result of a surge in debt. Since 1994, the notable reduction in public deficit of Greece has been due to both public revenue increases and public expenditure reductions.

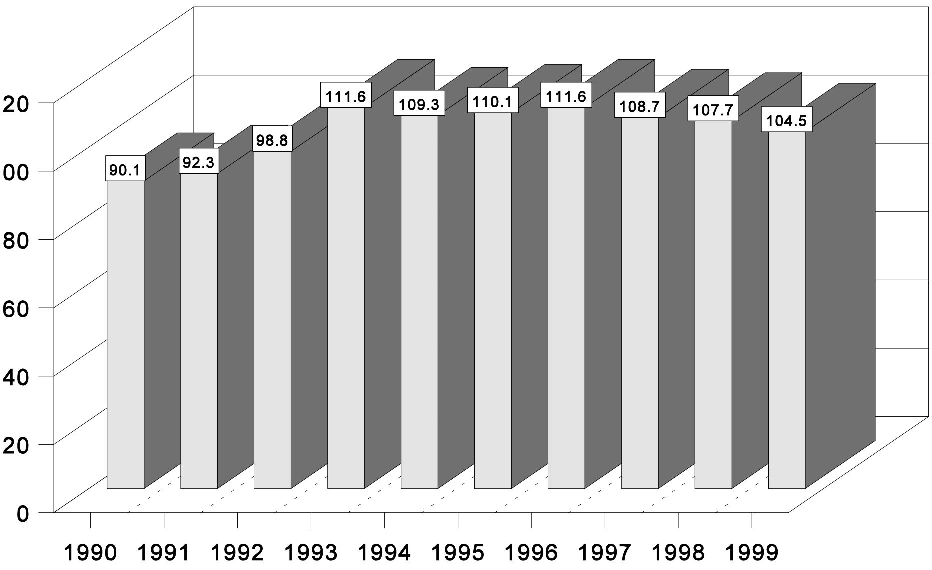
Further measures to combat tax evasion and to expand the tax base will be taken by the Greek government in order to reduce the budget deficit. At the same time, the government plans to decrease public expenditure by carrying out a fundamental reform of the economy, including a reduced public sector and a more flexible labour market.



The government‘s target in the budget for 1998, submitted for approval last November to the Greek Parliament by the Greek Finance Minister Mr Yiannos Papandoniou, is to reduce the budget deficit to 2.4% of GDP, as required in the convergence programme. Public revenue will be increased by 946 billion drachmas mostly due to the application of new measures in taxation. The government’s budget for 1998 foresees an increase of 11.2% in public revenues and a decrease of 4.9% in public expenditure in order to reduce the budget deficit of central government to 4.4% but it will turn out to be accurate only if the government manages to limit public expenditure so that it won’t have to impose more new taxes in the future.

Chart 3 : Budget Deficits as a % of GDP (1990-1999)

1998 and 1999 Commission forecasts



Source : EMI Report, March 1998

(d) Public debt as a percentage of GDP

Between 1990 and 1993, the Greek public debt increased from 90.1% to 111.6% of GDP. This increase was due mainly to a “stock-flow adjustment item” of public debt caused by the depreciation of the Greek drachma and to consolidation operations.

Between 1994 and 1997, however, the public debt level stabilised (with a peak of 111.6% in 1996); and then began to fall. This was possible because the primary balance recorded a surplus since 1994, thus outweighing the sizable impact of further “stock-flow adjustments”. According to forecasts, the Greek public debt should continue to decrease to reach 104.5% of GDP in 1999.

Interest payments is amounted to 9.1% of GDP in 1997, at an average interest rate of 8.9%. The amount of money needed for the repayment of previous loans reached 24.2% of GDP in 1996.
.
One notable improvement in the position since the early 1990s, however, has been the lengthening of the maturity. Whereas in 1990, less than half the debt had a maturity of a year or more, the figure in 1997 was 86.7%.

Chart 4 : Public Debt as a % (1990-1999)

1998 and 1999 Commission forecasts *Source: EMI Report, March 1998*

Table 2: Gross public debt - structural characteristics

	1990	1997
Total debt (as a % of GDP)	90.1	108.7
Composition by currency (as a % of the total)		
In domestic currency	76.8	78.4
In foreign currencies	23.2	21.6
Domestic ownership (% of total)	74.9	76.3
Composition by maturity* (% of the total		
Short-term (less than a year)	52.2	13.3
Medium- and long-term (one year or more)	47.8	86.7

** Original maturity* *Source: EMI Report, March 1998*

According to Eurostat, the Greek central administration is responsible for 95% of the public debt while public enterprises and social security organisations account for a small percentage.

Estimates made by the Commission do not show the level of Greek debt falling below the 60% reference level until 2007 (see Table 3). This would, however, be a rate of fall well within the precedents set by Belgium and Italy in qualifying for EMU in 1999, and would allow Greece to join in 2001.

Table 3: Sustainability of debt trends

	Government debt ratio in 1997 (as % of GDP)	Change in debt ratio 1996-97 (as % of GDP)	Actual primary balance in 1997 (as % of GDP) (1)	Debt stabilising primary balance in 1997 (as % of GDP) (2)	Debt stability gap* in 1997 (as % of GDP) (3)=(2)-(1)	Number of years needed to bring the debt ration below 60% of GDP**	Year when the debt ration falls below 60% of GDP

Greece	108.7	- 2.9	5.6	- 1.0	- 6.6	10	2007
EUR	72.1	- 0.9	2.6	1.3	- 1.3	7	2004

** A negative sign means that the actual primary balance is sufficiently large to bring down the debt ratio in 1997. The stock-flow adjustment is not taken into account for these calculations.*

*** The calculations are made as follows: Spring 1998 economic forecasts for the debt ratio until 1999 and projections thereafter, fixing interest rates on government debt at a common level of 6%, inflation rates at 2%, stock-flow adjustments at zero and keeping real GDP trend growth rates and primary balances constant at the levels forecast for each Member State in 1999.*

Source: "EURO 1999" (report of the European Commission of 25th March 1998) Table 4.8, page 111)

(e) Exchange rate stability

Greek monetary policy has for some years been guided by an exchange rate target linking the drachma closely to the ECU. In 1997, however, the drachma depreciated by 2.067% against the ECU and fell by 13.978% against the dollar and by 13.659% against the pound sterling.

The drachma then entered the ERM in March 1998. This means that Greece will probably be able to meet the exchange rate criterion for Single Currency membership by March 2000.

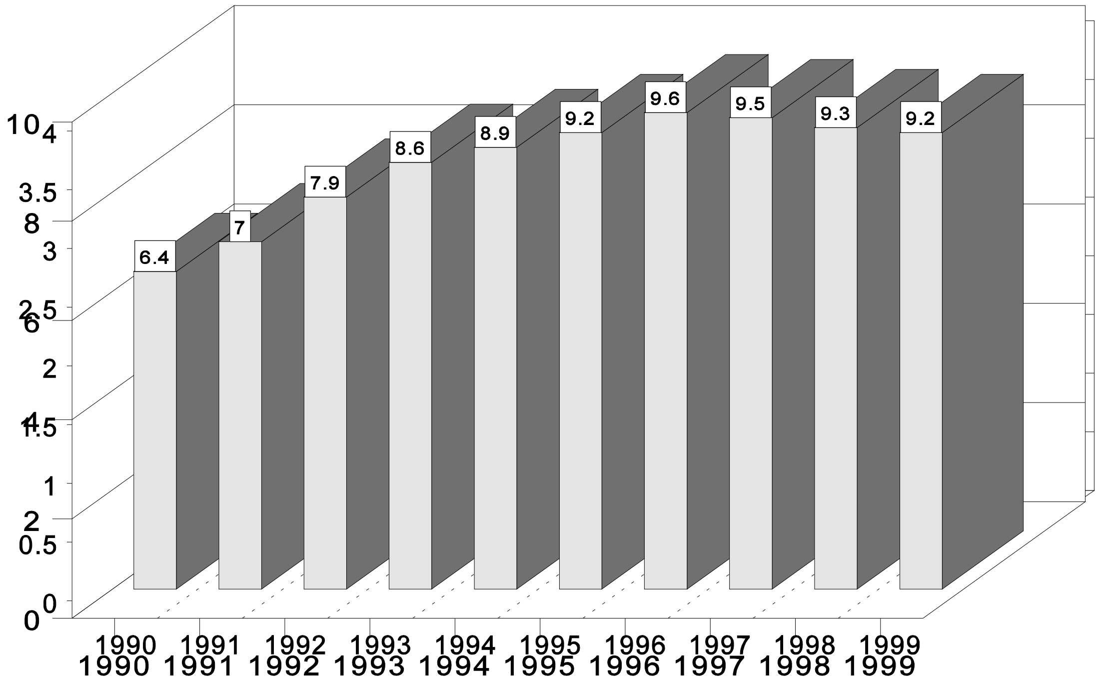
(f) Independence of the Greek Central Bank

Legislation bringing the status of the Bank of Greece into line with the requirements of the Treaty was adopted by the Greek Parliament in November 1997, coming into effect at the end of the year. It is therefore the opinion of the Commission that Greece already meets the necessary criteria for EMU membership - although it notes that the Bank has been given certain powers - e.g. to impose minimum reserves -which will need to lapse when the Bank forms ´part of the European System of Central Banks.

g) Growth and Unemployment

The economic recovery of Greece can be seen from the growth of GDP by 3.3% in 1997 (compared to 2.4% and 2.6% respectively for 1995 and 1996), mainly due to increased domestic demand caused by a high level of investment. Domestic demand remains the driving force of growth since the hard drachma policy caused exports to decline. Domestic demand in Greece grew even faster than GDP in 1997, thanks to a continuous increase in investment. From 1994 to 1996, the growth of GDP (2% on average per year) and the increase of the annual investment rate by 4.7% on average had a positive impact on employment, with the creation of 50,600 jobs every year.

Chart 5 : Growth of GDP (1990-1999)



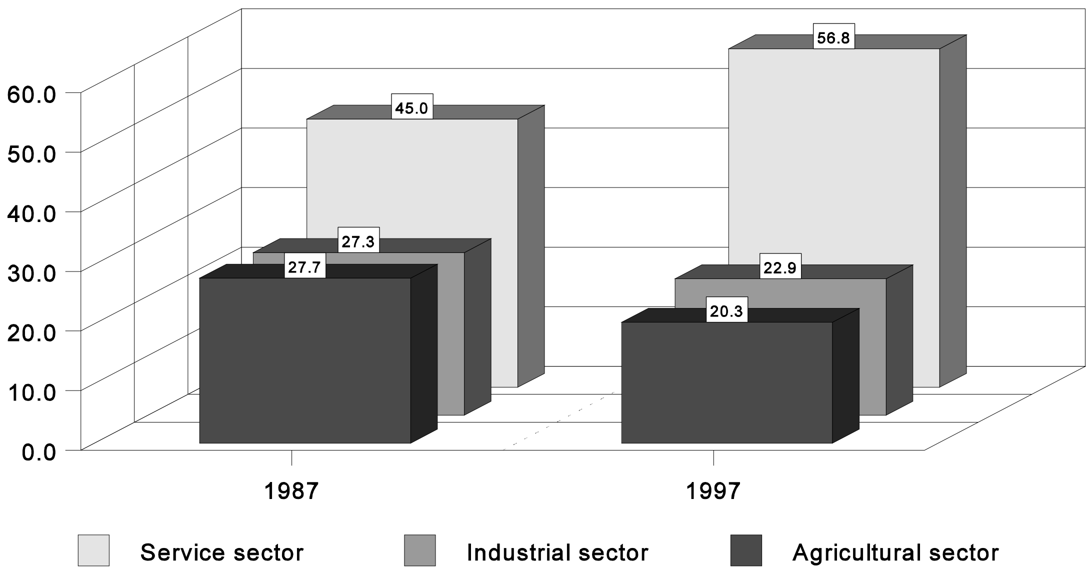
** 1998 and 1999 estimated*
Source : Eurostat and DG II

According to the National Statistical Service of Greece, the rate of unemployment has remained stable around 9-10% since 1993 despite the increased economic growth of that period. However, the recovery of the Greek economy is expected to reduce the unemployment rate to 9.2% in 1999. The number of long-term unemployed (people remaining without a job for more than a year) is increasing. In addition, high unemployment benefits absorb much of the government's money and encourage people to stay unemployed. Recently, the growth rate of the labour force has tended to be lower than the rate of people taking retirement. Unemployment in Greece is due mainly to the difficulty in finding a job and not to the loss of it. Finally, the problem of unemployment is more intense in urban centres than in rural areas and especially for young people entering the labour market without any job experience.

Chart 6 : Unemployment rate (1990-1999)

1998 and 1999 estimated

Chart 7 : Occupation of the labour force in the 3 sectors of the economy

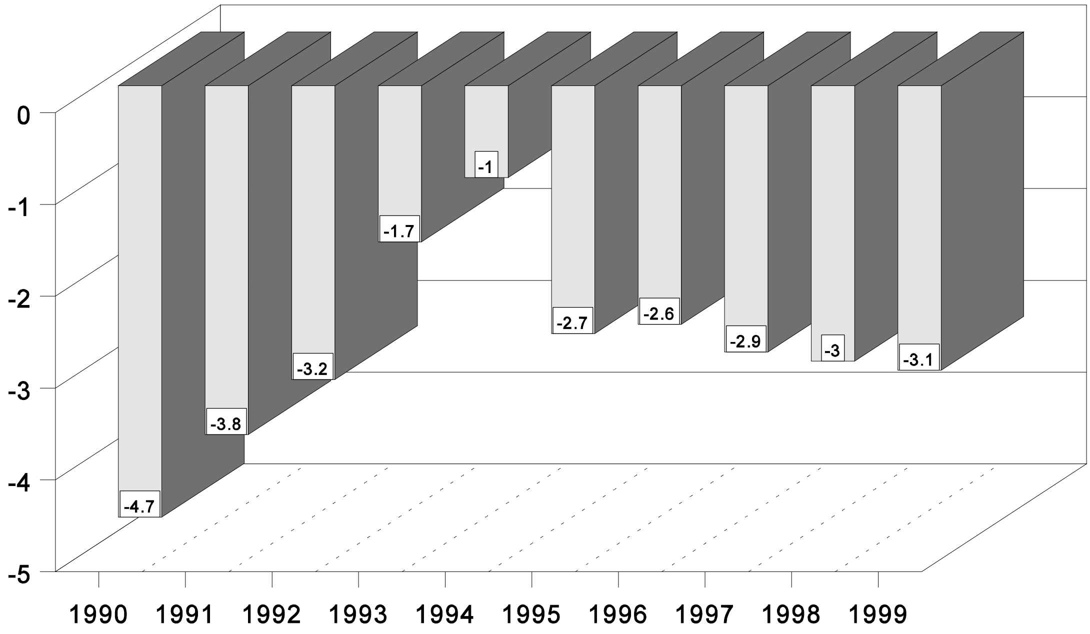


(h) Balance of payments

Greece’s balance of payments has been in deficit throughout the 1990s, although the recession of 1993/4 cut the level sharply.

The subsequent recovery of domestic demand, and the hard drachma policy, then caused an unavoidable increase, which could deteriorate even further in the near future.

Chart 8 : Current Account Balance (1990-1999)



Source : Eurostat and Commission DG II

According to the Governor of the Central Bank of Greece, Mr Loukas Papadimos, the effectiveness of monetary policy depends on the parallel implementation of a suitable economic policy that will increase the competitiveness of the economy and will reduce the pressures on the balance of payments.

The political background

(a) Government policy

The participation of Greece in Europe’s Economic and Monetary Union has been the main target of the Greek Government’s economic policy since 1994. Although it has taken considerable effort, great progress has been made in this direction during the last few years, and especially in 1997.

The *Socialist (PASOK)* Prime Minister, Mr Costas Simitis, has told the Greek Parliament that the central national target of Greece is now to join the EMU at the latest before the single European currency enters into circulation at the beginning of 2002. Accordingly, the Government has placed especial emphasis in its economic policy for 1998 on the reduction of inflation and its budget deficit.

This probably means that Greece is about to enter a period of an even more intense austerity, with further cuts in public spending, a speeding up of the privatization process of public companies and constraints on the number of civil servants. Given continuing public support for EMU entry, however the Government will probably be able to carry this through, despite some protests from the Party's left wing, and from other parties of the left.

(b) The Opposition

Although there are ideological differences between the governing party and the main opposition party, *New Democracy,* there are also a lot of similarities in their policies, notably on Economic and Monetary Union.

Mr Karamanlis, the president of New Democracy, is the nephew of Konstantinos Karamanlis, the founder of the Party, and thus comes from a family with a long political tradition. His election last year as the leader of New Democracy was basically the result of an effort to overcome the recent leadership disputes and internal conflicts between members of his party.

However, New Democracy is facing again a possible split after three ex-cabinet ministers, Mr Stefanos Manos, Mr Georgios Souflias and Mr Nikolaos Kondogianopoulos who abstained from the parliamentary vote on labour union reform were expelled at the beginning of February 1998.

The *Communist Party of Greece* is against Greece's participation in EMU.

(c) Industry

The Federation of Greek Industries (FGI) encourages the Greek government to adopt a strict budget with particular attention to reducing public expenditure and increasing privatization and supports all its efforts for achieving the aim of economic convergence. Industry in Greece, like in all the other EU Member States, is in favour of Economic and Monetary Union and certainly hopes that Greek products will have a competitive edge. As the president of the Federation of Greek Industries Mr Iasonas Stratos pointed out, there is still room for the further development of Greek industry and a lot of industrial sectors could attract foreign investment.

The Federation of Greek Industries (FGI) believes that the euro will benefit entrepreneurial activity because it will create an environment of economic stability where the existence of the single currency will abolish the risks from exchange rate fluctuations. It is also expected that the euro will increase competition and it will make the single European market more accessible. But at the same time businessmen in Greece are also worried about the high cost of and the lack of preparation for the transition to the euro. Although there is a positive climate in the business world in anticipation of euro, the vast majority of enterprises in Greece are not sufficiently prepared for the new economic reality after the introduction of euro.

From the 1st of January 1999, Greek enterprises will have to use the euro in a lot of their transactions regardless of when Greece will join the EMU. A recent research carried out by KPMG- business consultants shows that large European enterprises with over 5000 employees will have to bear a cost of 30 million dollars on average in order to adjust themselves to the euro, while all together will have to bear a cost of about 50 billion dollars.

The Federation of Greek Industries (FGI), in order to help Greek enterprises to prepare themselves for the transition to the euro, has recently published, in collaboration with Eurobank and the Association for the Monetary Union of Europe, an analytical guide called "The Euro and Enterprises".

(d) Trade unions

The main concern of the Greek trade unions in the context of EMU is the effect of preparing for membership on wage rates. Although the Greek government, following a tight fiscal policy, has practically frozen salaries in the public sector, government expenditure on salaries increased by about 14% in each of the last couple of years due to subsidies and the application of new payroll systems. In 1998 there is expected to be only a small increase of 2.5% in the salaries of civil servants.

On the forthcoming negotiations for the new National General Collective Agreement (NGCA) concerning the private sector, the Greek General Confederation of Labour (GGCL) intends to ask for a 6% increase in salaries for 1998 but the Federation of Greek Industries (FGI) is not willing to accept an increase of more than 4%. The trade unions have threatened that if their demands are not fully satisfied they will go on strike as they have done several times in the past.

The National General Collective Agreement (NGCA) is very important not only because it specifies the salary increases that will be given every year, which are usually the expected inflation rate plus the growth rate of GDP, but also because it sets the minimum wage and salary levels according to which about 20% of workers and employees get paid.

(e) Privatization

The Greek public sector covers 60% of the national economy and employs 25% of the labour force. At the end of September 1997 established civil servants in Greece numbered 292,041 and the contracted ones added another 24,096 to this figure.

Since 1993 the only major privatization has been that of the Hellenic Telecommunications Organisation (OTE). However, it is worth mentioning that over the same period of time 45 small public companies were also privatized, contributing about 80 billion drachmas to public revenue.

In January 1998, the Minister of National Economy and Finance Mr Yiannos Papandoniou presented a privatization plan covering eight public enterprises and organizations, to be implemented by the end of May 1998. This will contribute more than 250 billion drachmas to public revenue.

Moreover, Mr Yiannos Papandoniou is planning, despite the strong objections of the trade unions, to take radical measures in order to make a number of other public companies profitable again.
He intends to change the personnel regulations of the four largest public enterprises and organizations if ,during the period of the first six months of 1998, the dialogue between the administration and the labour unions does not end in a satisfactory solution. These public companies are Olympic Airways, the Greek Post Offices, the Hellenic Railways Organization and the Athens Public Transport Organization.

(f) The press

The majority of Greek newspapers fall into either the category of centre left such as ‘Ethnos’, ‘Eleftherotypia’, ‘Ta Nea’ and ‘To Vima’ or centre right such as ‘Kathimerini’, ‘Adesmeftos Typos’ and ‘Apogevmatini’. Most of the newspapers in Greece are in favour of the Economic and Monetary Union, with the sole exception of the Communist newspaper ‘Rizospastis’, which follows the official guidelines of the Communist Party of Greece and thus adopts a negative position towards issues related to the European Union.

(g) Public opinion

The Greeks are one of the EU Member States with the most positive attitude to the European Union. According to a recent Eurobarometer there has been a strengthening of support for European Membership in Greece. Sixty-one percent of Greek citizens believe that the membership of their country in the European Union is a “good thing”, while only eight percent consider it to be a “bad thing”. Finally, sixty-five percent of the Greeks are in favour of a single currency and only twenty-four percent are against it.