Economic Policies in Greece During 1990-1993: 
An Assessment 
by Theodore Pelagidis* 
Ph.D. Fellow at the Center for European Studies, 
Harvard University 
and 
SPES Researcher of the European Communities in the 
University of Paris VIII 
(November 1993) 
Working Paper Series #46

Abstract

This paper deals with the assessment of the economic policy followed during the period 1990-1993 in Greece. It analyzes in particular the evidence and the results of the applied conservative prescription at that time. While the results of this policy proved to be negative according to the arguments as well as the findings of this paper, a new policy agenda is sketched out. Proposed policy directions share the view that in order to break away from the economic crisis in Greece, priority should be given to economic growth, paying attention to public investments in infrastructure in order to generate productivity increase of the private sector, raise the level of business activity, and reduce the risks facing individual firms. A differentiated, selective and, according to market signals, gradual sliding of the national currency is this paper's proposal for the crucial field of exchange rate policy.

*The author would like to thank the E.U. for its financial support through SPES funds. An oral version of this paper was presented at the Center for European Studies at Harvard University on November 30 and at the Fletcher School at Tufts University, Boston, on December 1, 1993. Comments from the audience are gratefully acknowledged as the source of improvements in this paper. Of course, the responsibility for the arguments presented remains mine.
INTRODUCTION

It is widely supported in Greece that excess demand and extremely high public debt and budget deficits constitute the main problems of the economy, responsible for the poor macroeconomic performance since the '80s and beyond. The conservative party which took power early in the '90s, facing intense macroeconomic imbalances, adopted at once a package of hard austerity measures in order to cut down the budget deficit and restrict domestic demand. The persisting economic crisis and the failure of sustainable growth were considered the outcome of past policies which had increased wages above inflation and productivity and promoted state intervention especially through the increase of unproductive public consumption expenditures. Three and a half year later, a political crisis provoked by the unpopular austerity measures, brings back to power the Socialist Party (Pa.So.K.), which as believed, will put an end to the "extreme monetarism" applied before. Despite this clearly declared intention, it seems that even within the socialist party, it is widely accepted that the government's new economic policy should, more or less, run on the same lines. Pro-socialist policy makers advise that general stabilisation measures, backed by a social concensus, are needed to bring the economy back to a stable macroeconomic environment. Carefully devised political movements and delicate words seem to be up to now the way of implementing and applying a "mild monetarist policy". Notwithstanding, it is unfortunate that few of the policy-makers who support conservative ideas even within the socialist party, present detailed and convincing arguments to justify the rationale behind the measures taken while, at the same time, this "al a mode" blind
devotion to a mania for austerity prevents them from keeping a cool head to evaluate the existing 3.5 year results of such a policy. In response to such an attitude, this paper makes an attempt to present and explain the goals and the rationale of the economic policy followed in the last three and a half year in Greece and more importantly, seeks to analyse the evidence and the results of this applied extreme monetary prescription.

1. Poor Macroeconomic Performance and Prevailing Diagnosis

It will not be news to anyone that the macroeconomic performance of the Greek economy during the '80s was not impressive. Real GDP grew at an average annual rate of 1.1% which is a low percentage both per se and compared to the GDP increase of the European Union (E.U.), around 2% (Spraos 1991: 1). Taking into account that Greece as a full member of the E.U. has both the obligation and the ambition to approach European standards, the increase in Greek GDP was rather disappointing. Despite periods of intense income restraints (1983, 1986, 1987, 1990), inflation proceeded at an annual average rate of 18% in the past decade. The current account deficit averaged -5.2% of GDP in the years 1980-1989, while the foreign currency debt increased from 10.6% in 1980 to 31% in 1989. At the same time, unemployment rose from 4% (1981) to 7% (1989), an almost double increase although still below the European peak rate of 11%. Industrial production remained almost stagnant - 0.8% average change during 1984-1991 - while the share of manufacturing production as a percentage of GDP retreated from 17.2% in 1975-1979 to 15.8% in 1985-89, facts which are both attributed to poor industrial productivity performance especially in the first five year period (-1.0% in 1980-84 and 2.4% in 1985-89).
The deterioration or at least the relevant stagnation of the main macroeconomic indicators is considered as a result of a huge public sector deficit which run at an average rate of 17.7% of GDP during 1984-91, and reached a record level equivalent to almost 19% in 1990, by far the highest level in the OECD area (Barkleys 1993:12).

Since 1990, a year in which the conservative party took power, tough austerity measures have been taken with the goal of stabilizing the economy and bringing Greece closer to its European partners. Economic policy focused on the - believed - sources of macroeconomic disequilibrium: the huge budget deficits and the excess demand coming mainly from increases of wages above productivity during the last decade. Budget deficit, a concept familiar to economists, is constituted by the amount by which expenditures exceed tax revenues and regularly this amount must be borrowed or added to the total debt. Hence, debt is the sum of all past net borrowings. In the case of Greece, the applied neo-conservative analysis (Alogoskoufis 1990, 1991, Papademos 1989, Pavlopoulos 1986, 1989, Pavlopoulos and Kouzelis 1990, Economou 1991) attributes massive deficits to excess spending expenditures, referring in particular to excess public consumption and increase in private and public sector wages. Most of these expenditures are considered as a waste of resources which indeed provoke crowding-out effects in the private economy. As a result, nominal interest rates are going up so that the state may be able to pull capital resources in order to cover its deficits. One must remember that during the '80s the short-term nominal interest rates were at an average rate of 20%, a fact that, as it is argued, pulled resources away from private investment. On the other hand, excess domestic demand is considered to be the primary cause of high inflation as well as of the significant reduction of private sector profit rates which
had a negative side effect on investment decisions and, as a result, on productivity performance. Authors who support these arguments characteristically mention that public expenditures reached the unprecedented 49% of GDP at the end of '80s, fact which, together with excess public consumption rates, had negative effects on inflation as well.

In the reports of the influential conservative Institute of Economic and Industrial Research (IOBE), the enormous increase of the wage income share during the '80s, is particularly emphasized. Vice-director of the Institute Professor Economou (1991), points out that the income share of wages increased from 58.2% in 1981 to 66.8% in 1985, an increase which continued for the rest of the decade (1986-1989). The real wage in manufacturing increased cumulatively 4.4%, while productivity decreased -2.2%, having as a result a total net increase of the real wages for the whole decade of 16% (Economou 1991: 58 and : 72). G. Pavlopoulos (1986, 1989), Professor and Director of the same Institute and an advisor to the conservative government, estimates in detail the negative impact on profits due to an increase of real wages, a fact that is considered of cardinal importance for private investment decisions and hence for productivity increase and competitiveness. The same authors argue that real wage increase had a negative side effect to the marginal propensity to save, which from 22% of GDP in the '70s went down to 6% in 1987.

2. The Conservative Policy Perscription

Having supported the above diagnosis, the conservative government proceeded since 1990 to implement tough stabilisation measures focusing, in the first place, on efforts to reduce the deficit from 19% of GDP
(1990) to 3\%, and the total debt from 76.3 \% (1989), to 60\% (Epilogi 1993), so as to meet two of the most central convergence criteria of the Maastricht Treaty. Hence, to bring the economy closer to European standards, and to break away from the economic inertia provoked, as was believed, by the extremely high public sector borrowing requirements (PSBR), the conservative government announced a number of drastic fiscal measures. Besides a drastic overhaul of social security expenditures, higher indirect taxes and public utility prices were soon applied to increase state revenues and to compensate for the tax short-fall especially in the 1992-93 years, together with an urgent plan to de-nationalise state-owned enterprises like the cement company "AGET-Hercules", the Greek telecommunications corporation "OTE", shipyards, public transportation, etc. With the speeding-up of the privatisation process it was hoped that the state would get rid of public enterprises' deficits and get money from their sale so that the primary budget balance could show a surplus of 5\% of GDP in 1993, rising to 7.7\% until 1997. However, in the measures applied we should emphasize the corporate tax reduction to 35\% and the personal income tax highest rate reduction to 40\% (Barkleys: 6), in order to increase profits and as hoped, investments.

Shifting to the income policy, tough real wage cuts were adopted to diminish labour costs so as to decrease domestic demand and slow inflation. Pressuring demand and so keeping down inflation was considered as a precondition to cut interest rates and, as a result, state back payments and deficits. In fact, with inflation pressures persisting at the high levels of 15.8\% and 14.5\% the last two years 1992 and 1993 respectively, the public sector pay award of 5\% in 1992 and 4\% in 1993, brought down relative wage levels and did positively influence private sector profits. After tough real wage cuts in 1991-1993, payroll cuts are
expected to reduce the state wages bill from 12.4% to 11% of GDP by 1996 (Barkleys 1993: 6).

As regards exchange rate policy, the scope was to keep the national currency within a very narrow range of fluctuation, around the ECU parity, with the prospect of entering the drachma into the European Exchange Rate Mechanism (ERM), as a first step of Greece's participation in the process of the European Monetary Union (EMU). Recent estimates put the overvaluation of the drachma at 20-30%, fact which has partly been the result of an anti-inflationary "crawling peg" policy in the last two years (Alogoskoufis 1993).

Finally, as for the liquidity of the economy, interest rates were supposed to enter in a process of gradual cut down by early 1994, along with a decrease of public debt. Money supply and credits to the economy also contracted. From 16.9% annual percentage change in 1990, credit expansion slowed to 10.8% and 9.8% in 1991 and 1992 respectively from its peak rate of 23.6% in 1989 (OECD 1993a: 60). M3 grew by 15.3%, 12.3% and 15% for 1990, 1991 and 1992 respectively, from 24.2% in 1989, following the same lines (op.cit.: 62). According to conservative policy-makers this would contribute to a drastic decrease of the liquidity of the economy, a fact which usually contributes to a deceleration of inflation and in a way counterbalances considerably liquidity issuing from the huge budget deficits and the massive debt.

Concluding the above policy perscription, we would say that during the years 1990-93, the conservative government adopted a total of tough austerity measures to slow inflation and to reduce the budget deficit. This type of irreconcilable monetarism was considered as the only way to succeed in the above goals, bring the country away from economic crisis, and also to meet Maastricht criteria. But other things are not equal. The
The Maastricht treaty defines concrete nominal economic targets to be reached and sets deadlines for these to be achieved. It does not spell out the right policy to meet the goals. It is supposed to leave free ground to each member-State to apply the suitable policy prescriptions in order to succeed the targets, although the latter are subject more to political criteria and they are not designed according to purely economic logic. Notwithstanding, leaving aside the Maastricht treaty per se, we will make an attempt to assess the policy applied since the early '90s examining in the first place whether the government achieved the objectives set.

3. Results and Critical Assessment

Our first task is to consider the diagnosis for macroeconomic disequilibrium. Is it true that excess demand is found at the heart of the problem? It is reminded again that excess demand is believed to be created by extraordinary wage and public consumption expenditure increases during the decade of the '80s.

Contrary to what is commonly believed, during the '80s (1980-1990), the average annual change of total domestic demand in Greece was 1.3% (OCDE 1991), while the GDP per head grew at an annual rate of 1.7% during 1981-1991 (European Economy 1990: 239). Private consumption cumulative change in constant prices grew in Greece at 21% (1979-1989), while in the E.U. it grew at 24% in the same period (OECD 1991: 56). Private consumption in Greece was 51% of the community average in 1981, but dropped to 41% in 1991, a fact that we should attribute to the fall of the relative wage levels from 55-56% of the OECD and E.U. averages (in common currency), to 42-45% in 1991 (OECD 1993a: 29). Therefore, as Vergopoulos (1991,1992,1993) rightly observes
the above evidence is highly incompatible with the overconsumption theorem and interpretation of crisis as perceived by conservative policymakers. On the other hand, Greece presents the highest saving propensity of households (around 20%) among the E.U. countries (14% average) (AGI 1992: 12-13), so we can certainly support that there is neither insufficiency of saving nor overconsumption tendencies at the expense of savings and investments. As for public consumption, although it is true that consumption grew constantly during 1980-89, it certainly remained at European levels, around 19% of GDP against 18.5% in the E.U. (OECD 1991: 66). The cumulative growth of real public consumption expenditures during the years 1982-1992 was 19.8% for Greece against 21.0% for the E.U. (OECD 1993b: 204). We should also mention that public expenditures as percent of GDP reached the European levels only in late '80s (around 50%), although what the state receives from the economy (around 35% of GDP) is far behind the European standards (45%), a fact which, according to our interpretation for the economic inertia today in Greece below, proves to be of cardinal importance.

The above evidence, which primarily refers to the excess domestic demand issue, is perfectly matched with the evidence concerning labor wages and costs. The real average wage per head grew in Greece at an annual average rate of 0.9% during 1983-90, while in the E.U it exceeded 1.5% (COM 1989: 60). The relative labour cost - per unit of product - in

**TABLE 3.1**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>GREECE</td>
<td>83.7</td>
<td>82.2</td>
<td>67.4</td>
<td>63.7</td>
<td>68.5</td>
<td>71.1</td>
<td>72.6</td>
<td>68.1</td>
<td>65.2</td>
</tr>
</tbody>
</table>

common currency, as can be easily seen by table 3.1 above, was 83.7 in 1984 of the European one, while in 1982 it fell off to 65.2%. Finally, Eurostat statistics show that, real wages in Greece are going down by 1.6% per year since 1985, while in all other E.U. countries real wages increased, from 2.8% in Germany - the higher % - to 0.7% in France - the lowest % (Eurostat 1992: 1).

After presenting and analysing so much data which deals with various aspects of the so-called "domestic demand" in the economy, we can definitely maintain that any problems of macroeconomic disequilibrium can not be attributed to excess demand, overconsumption and generally unproductive waste of resources coming from excess public or private consumption. We saw that, contrary to what is commonly believed, domestic demand was kept at low levels, in fact lower than the slight increase of GDP; public consumption and expenditures are at European standards showing convergence with the E.U. and not imbalance; at the same time, divergence is observed on state revenues and on wages, although the government in power during the '80s was a socialist one.

Let me now embark on the more complex issue of public debt and deficit, which, as mentioned above became the main concern of the policy-makers during 1990-93. As has been noted before, conservative authors still consider the annual public sector borrowing requirements (PSBR) as responsible for high inflation rates as well as for keeping interest rates up, a fact that it is commonly believed, pulls resources away from private economy and provokes dis-investment and crowding-out effects. I am not going to enter territory concerning theoretical issues about the relationship between interest rates and budget deficits, but I am almost urged to point out that government deficits do not necessarily
affect interest rates and investments. As Prof. Barro at Harvard University states clearly, government budget deficits do not necessarily affect interest rates, investment or anything else because the increase in private saving exactly offsets the fall in public saving. Along the same lines, we would say that the deficit affects interest rates only when the economy is near its potential level of output, which means that only from the point of full employment does it pull resources away from private investment. Deficit reduction stimulates investment through the freeing-up of resources only in the case in which the latter is not available. In any other case, problems are getting worse by excessive deficit reduction and we support that this is the case of Greece in the last three years or so. Gross household savings as a percentage of disposable income was 20.1% in 1991 in Greece and 14% in the E.U. (AGI 1992: 12-13). Therefore, the economy, despite high public borrowing, does have idle resources available indeed at such a level so that the view that private economy suffers from crowding-out effects can not be supported.

As I have cited before, contrary to the demoralizing syndrome about the wasteful, consumption-natured and unproductive Greek State, public consumption and expenditures do remain around the European standards. But if this is true, then what provokes the continuing increase of the total debt from the early '80s onwards, a fact that according to some academic analysts confirms "State hypertrophy" in Greece?

It is at first glance paradoxical that the highly restrictive policy adopted since the early 90s, while slightly reducing the PSBR at the same time massively increased the total debt, as you can realise for yourselves in table 3.2. But let us take things from the start. Looking at the composition of public expenditures and revenues one can easily realize why the debt explosion of 1990-93 can no longer be a mystery. As we can
see from table 3.3, public expenditures as a % of GDP have risen from 28.9% (1981) to 32.1% (1985), 37.5% (1988) and 47.8% (1992).

**TABLE 3.2**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>PSBR*</td>
<td>13.5</td>
<td>19.6</td>
<td>21.0</td>
<td>15.6</td>
<td>10.9</td>
<td>9.0</td>
<td>-</td>
</tr>
<tr>
<td>PSBR**</td>
<td>-</td>
<td>-</td>
<td>18.6</td>
<td>16.1</td>
<td>13.2</td>
<td>10.6</td>
<td>-</td>
</tr>
<tr>
<td>DEBT***</td>
<td>71.5</td>
<td>76.3</td>
<td>88.8</td>
<td>95.9</td>
<td>101.4</td>
<td>105.0</td>
<td>-</td>
</tr>
<tr>
<td>PSBR#</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>15-18</td>
</tr>
</tbody>
</table>

+Predictions, estimations.
Sources: *OECD (1993a: 51).

#While 1993 is ending, evidence announced just before submitting this paper, shows that the budget deficit for 1993 finally reaches 14-15%. Prof. L. Katseli, member of the council of economic advisors, person in charge of the 1994 budget report and personal advisor of the prime minister A. Papandreou, in a talk given in the Kennedy School at Harvard in November 1993, puts this number at 18%.

**TABLE 3.3**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>28.95</td>
<td>37.53</td>
<td>43.65</td>
<td>47.81</td>
</tr>
<tr>
<td>Interests &amp;</td>
<td>-</td>
<td>8.56</td>
<td>11.91</td>
<td>9.92</td>
</tr>
<tr>
<td>Amortization</td>
<td>-</td>
<td>2.03</td>
<td>3.36</td>
<td>12.35</td>
</tr>
<tr>
<td>Primary expend.</td>
<td>25.21</td>
<td>26.95</td>
<td>28.38</td>
<td>25.54</td>
</tr>
</tbody>
</table>

reports like the European Economy (1990), raise the above number to 46.2% of GDP as average annual rate during the period 1981-1990. Whichever report is closer to the reality, one can easily realise that 46.2% is even lower than the relative E.U. rate of 48.0% - the average annual rate in the same period. Looking at the composition of public expenditures we observe that primary expenditures as a % of GDP remained relatively stable: from 25.2% in 1981, rising only to 28.38% in 1988 and dropping again to 25.5% in 1992. Thus, even this legitimate, according to European standards, increase of public expenditures since the early ’80s is definitely not due to new/added primary expenditures. It is evident from table 3.3 that the increase arises from the explosion of interest and amortization payments which grew from 10.59% of GDP in 1988 to 22.25% in 1992. Total payments for interests and amortization as a % of public expenditures alone, also rose from 17.5% in 1988 to 42.2% in 1992 (Epilogi 1993: 24). To counterbalance the huge interest payment increases the share of wages and pensions in GDP - again contrary to what is commonly believed - decreased from 14.07% of to 12.45% in 1992. To cover the widening deficit, policy proceeded during

| TABLE 3.4 |
| --- | --- | --- | --- |
| Indirect taxes | 13.1 | 16.8 | 17.6 | 19.3 |
| Direct taxes | 6.1 | 6.9 | 7.7 | 7.9 |
| Total tax revenues | 19.3 | 23.8 | 25.3 | 27.2 |
| Non-tax revenues | 1.3 | 2.0 | 1.7 | 3.1 |
| Total revenues | 20.6 | 25.8 | 27.0 | 30.4 |

1990-93, to a large increase in taxes (revenue side). Total tax revenues increased from 22.3% of GDP in 1989 to 27.2% in 1992 (table 3.4). It is worth mentioning that this increase came mainly from indirect taxes (OECD 1993a: 50), while revenues from direct taxes shows only a 1% increase during this period, coming mainly from taxes on deposit interests (Ministry of Finance 1992). On the contrary, it is reminded that corporate tax was reduced to 35% (Barkleys 1993 :6). Despite indirect tax increase, Greece is still considered to be around the European levels (E.U. 19.0%), that is 19.1% of GDP for 1991 (AGI 1992: 12-13), although an important increase in indirect taxation with the measures taken in August 1992 should have slightly risen the figure.

Concluding from all of the above, two things are beyond any doubt. The existing big deficit should be attributed to a large extent to: a) the low level of state revenues, which were mainly a result of low direct taxes especially on incomes and profits. State revenues in Greece which come from taxation on incomes and profits constitute only 6.5% as a percent of GDP, while in OECD the correspondent figure is 14.5% (OCDE 1990: 141) and, b) to a serious increase of expenditures for debt service payments. Notwithstanding, in case we add to the official GDP the one that is produced in the so-called "atypic economy", and which is estimated around 30% (Pavlopoulos 1987), or even 50% of the official GDP according to Professor Angelopoulos and Barkleys (1993: 6) estimates, then state expenditures and revenues, as a % of GDP, are much lower than the official numbers indicate. Finally, at this point, it is worth mentioning that there are studies which indicate that this percentage should even be less when we estimate the inflation-adjusted PSBR (Spraos 1991) or when we modify calculations and leave aside state guarantees for private sector's borrowing or include state-owned corporation deposits in

Going back to the issue at hand, that is the assessment of the conservative monetarist policy applied in the last 3.5 year, we can now definitely support that the diagnosis was wrong. There is no way to support, as proved, that macroeconomic imbalances stem from either excess demand or a state that is, in size and intervention, consumptionist and wastefully hypertrophic. The deficit should not be considered structural since it is fed mainly by interest and amortization payments (expenditure side) and from the state's weakness, inability and unwillingness to impose and collect direct taxes (revenue side). The conservative government predicts a decrease of the deficit to 10% of GDP in 1993 (table 3.1), but even if this fall off comes true, total debt keeps increasing and will, even by optimistic predictions, exceed 105% of the GDP in 1993. On the expenditure side, we remarked that an ever increasing percentage goes for interest payments while primary expenditures remain stable. As long as the real rate of interest paid by the state remains higher than the real GDP increase, the debt will keep increasing for the foreseeable future. It is estimated that under these conditions it would need, from now on, high surpluses on the primary budget of central government in order to cover every "new" deficit coming from the deduction: real interest rates payments-increase of real GDP. But raising indirect taxes as well as efforts to cut spending in order to achieve a surplus in the budget excluding interest payments, it subtracts income from business and consumers, reducing even more purchasing power, profitability, consumer spending and investment (Galbraith 1993). Besides, high interest rates are not only kept artificially high in order to attract capital and compensate for low state revenues, but also because of
the need to prepare the national currency to formally enter the European Exchange Rate Mechanism (ERM) and keep up with Maastricht obligations regarding the creation of a common European currency (ECU) and so, as is believed, fight inflation. First of all, a high degree of exchange rate fixity requires correspondingly high levels of real interest rates, which further speeds-up the debt accumulation process both directly by increasing the interest payments on debt, and indirectly by reducing the demand for high-powered money and the growth rate of output (Papademos 1993: 153-154). Thus, this policy keeps the deficit at high levels and balloons debt, while at the same time, high interest rates hit the real economy and bring on economic inertia as the increase of GDP can not counterbalance high interest rate payments. Moreover, this has the result of an increase in the average rate of state services in order to cover the deficit, and it leads to an increase in prices and inflation. Inflation today remains around 15% and a recent tendency to fall by 2-3 points rapidly overturned by a need to increase taxes (from 22.3% of GDP in 1989 went to 27.2% in 1992) in order to cover an unexpected high deficit in the end of 1992. The fight against inflation does not take place neither by keeping the drachma parity high because a "hard currency" policy weakens trade balance. From -11.9 as % of GDP deficit in 1988, trade balance grew at -15.8 % in 1992 (OECD 1993a: 71) and thus, deterioration continues. While the trade deficit is growing, the artificial nominal drachma parity is seriously undermined, while sentiment about the drachma is dominated by the performance and prospects of the current account. Then, real parity falls off due to growing trade deficits, reinforcing market speculation over the national currency and keeping inflation at high levels, despite the fact that economy is in an unprecedented deep recession. This policy, combined
with excess disabsorption by highly restricting domestic demand, had as an outcome even more catastrophic results on the real/industrial economy. The fall off in domestic demand reduced the size of the domestic market and diminished economies of scale for enterprises, increasing the per unit cost - and furthermore boosting inflation once more. Enterprises, even those with much potential, find it always more difficult to compete in the international market arena when imports are subsidized via the undervaluation of the foreign currency while, at the same time, exports are taxed by an "expensive drachma". As a result, they find only one way to restore competitiveness through the Blustonian-Harrisian (1988, 1990) "low road restoration of profits" which is based on low wage labour force, and restores competitiveness in the short-term, but definitely undermines it in the long-term by lowering investments and preventing technological change (Cohen and Zysman 1987, Pelagidis 1989, 1993). It is estimated that only as a result of further wage cuts alone, there has taken place a sharp increase in Greek profitability of up to some 80% since 1990 (Barkleys 1993: 3), without actually increasing investment rates correspondingly (see table 3.5), contrary to what conservative policy-makers expected.

**TABLE 3.5**

GROSS PRIVATE INVESTMENTS*

<table>
<thead>
<tr>
<th>YEAR</th>
<th>MIL. DR.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1985</td>
<td>56000</td>
</tr>
<tr>
<td>1989</td>
<td>64027</td>
</tr>
<tr>
<td>1990</td>
<td>73412</td>
</tr>
<tr>
<td>1991</td>
<td>65943</td>
</tr>
<tr>
<td>1992</td>
<td>64803</td>
</tr>
</tbody>
</table>

Source: OECD (1993a: 104). *In constant drachmas
The sharp increase in unemployment to 11% should also be considered equally damaging to the economy not only because this threatens social justice and destroys society's cohesion and social conditions for productivity increase, but also because it "represents" lost potential output. According to Professor R. Eisner (1993), high unemployment does not only mean waste of resources, as I have stated above, but also adds to the deficit in the short-term and the amount grows over time as additional deficit adds more to the debt and future interest payments. A loss of potential output means, furthermore, a loss in potential future investments which would increase productivity, competitiveness, having the side-effect of decreasing the debt and deficit by enlarging and deepening the taxable "base" of the economy and by increasing GDP. Thus, the potential deficit of the so-called "full employment budget", would be less. As a result, we can say that today's fiscal policy in particular is even more restrictive than it appears to be with the conventional calculation.

On the other hand, the healthy part of the Greek industry enjoys extremely high profit shares which exceed 60% although the relevant percent in the OECD and in the G7 countries is around 44% (OECD 1989: 124). Since 1990, there has also been a sharp recovery in Greek profitability, up some 80% as mentioned above (Barkleys 1993: 3). Direct state aid to manufacturing as a percent of value added was around 20% in Greece, while in the E.U. it was lower than 4% during 1986-90 (OECD 1993a: 16). Combining together at the same time, low taxation on business, low state revenues - coming from low taxation on incomes and revenues - high private profits, low investment rates and high public deficits, all these constitute a substantial state contribution to the private economy. This, "hidden" state back up to individuals as well as to
industrial competitiveness in particular, together with its low size and intervention to the economy, signifies in our view a particular "state atrophy" in Greece. It should be repeated and emphasized at this point that high interest payments by the state, in order to attract funds to counterbalance diminished budget revenues, constitutes in fact the way to feed private profits and makes the "crucial link" between the state and the private sector. This unique manner of state contribution substitutes today for the "old road" of state backing private revenues in Greece, namely the high state subsidies and general protectionism which took place in the era before Greek accession to the E.U. Significantly, this closed "vicious circle" of financial flows between state borrowing from the private economy through bonds, and the state back payments to it at high interest rates, in fact feeds speculative in nature capital which is not invested.

### TABLE 3.6

**SOURCES OF PSBR FINANCING**

(Share in %)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Internal borrowing</td>
<td>86.9</td>
<td>87.9</td>
<td>87.5</td>
<td>95.9</td>
</tr>
<tr>
<td>State Bonds purchased by:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Banks</td>
<td>42.2</td>
<td>16.1</td>
<td>1.8</td>
<td>-27.9</td>
</tr>
<tr>
<td>Individuals &amp; enterprises</td>
<td>18.9</td>
<td>43.1</td>
<td>68.0</td>
<td>93.7</td>
</tr>
<tr>
<td>Borrowing by commercial banks</td>
<td>15.8</td>
<td>13.7</td>
<td>12.7</td>
<td>-2.8</td>
</tr>
<tr>
<td>Bank of Greece</td>
<td>10.0</td>
<td>15.0</td>
<td>5.0</td>
<td>32.8</td>
</tr>
<tr>
<td>External borrowing</td>
<td>13.1</td>
<td>12.1</td>
<td>12.5</td>
<td>4.1</td>
</tr>
<tr>
<td>Total</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

*Jan-Sept predictions

productively but instead contributes to the well-being of a "neo-compradoric" class which seems to live from interest revenues alone and at the expense not only of the agrarian and labour class but also of industry. In table 3.6 we have the opportunity to consider the economy's most serious problem which seems to lie in the increasing share of individuals and enterprises state bond purchase which reach at a peak level in 1992. This table shows that funds, instead of being directed to real investments on machinery and equipment - which increase productivity and competitiveness - go to the purchase of state bonds simply because the latter are more profitable. Thus, industries learn to rely more on low wages, avoiding investments on new technologies and investing more on state bonds (on speculation capital see: Sweezy and Magdoff 1987, Cohen and Zysman 1987, Bluestone and Harrison 1988, Pelagidis 1993).

Policy Guidelines and Conclusions

Intervening directly at the source of the problem is the main principle of economic policy. It is really unfortunate that in Greece, during the crucial years 1990-93 when a new policy was applied, the rule of optimal intervention was so much distorted by hitting domestic demand and creating excess disabsorption when the source of the problem was found in the supply side. Deficit reduction was the wrong criterion and target to use in the first place - not that it was unimportant, only that it was not the main issue. After 4 years of "wild monetarism", a slight decrease in the budget and current account deficit, together with some marginal decrease in the inflation rate since 1990 - in 1988 it was around 13% - constitute unimportant and only temporary improvements which
indeed took place at the expense of the industrial base of the country. As for the current account, it is estimated that for 1992 -2.7% of GDP from -4.7 in 1989 and -5.4% in 1990, although it was only -1.8% in 1988 (OECD 1993a: 71). As we saw before, within current account in non-oil trade balance in particular, which mainly reflects competitiveness (terms of trade non-included), things are getting worse. From -11.9 as % of GDP in 1988 negative non-oil trade balance grew at -15.0% in 1991 and -15.8% in 1992 (op.cit.: 71) and this deterioration continues mainly due to the hard currency policy. Indeed, deterioration would be even worse if imports were not hit by domestic demand restrictive policy. However, you can overvalue one, you can overvalue a bit more a second time but you can not keep extending overvaluation indefinitely without avoiding damages in the production sphere (Spraos 1991). Under a "hard currency" regime, it is indeed very possible that after a long period of recession, production could be so weak that it could not even respond to any increase of demand at that time. In that case, the most possible effect is that demand would be directed mainly on imports and then, trade balance will worsen even more. Authors who support "hard currency" policy believe that in any other case inflation will boost again, especially the "imported one" and then it would not be possible to bring down interest rates. We must mention at this point that:

a) it is very possible that in the case that we let the currency slide according to market signals, foreign competitors will keep prices down so as not to lose their domestic market share and,

b) by letting the currency find its true equivalence, we make exports more competitive and so increase production, thus compensating for the undervaluation and counterbalancing inflation expectations coming from it by enforcing production and improving trade balance.
Moreover, exchange rate parity should follow more closely the currency fluctuations of those countries which especially produce goods competitive to Greece, like Spain, Portugal and Ireland so we can efficiently support national competitiveness. Therefore, although exchange rate policy is a very delicate matter and a very sensitive one and thus careful movements need to be made, a selective, differentiated and gradual sliding of the national currency is what this paper proposes for the time being.

As for the budget deficit in particular, it becomes quite clear from our analysis that if the state keeps up paying real interest rates which exceed real GDP growth, any slight deficit decrease will be overbalanced by a deterioration in the total debt ratio. Our analysis proves that a large part of the deficit is traceable directly to the slow economy. Any effort indeed to reduce primary expenditures today would even worsen the current economic stagnation. However, an effort to restructure public expenditures on investment-led activities would be much preferable.

The policy followed since 1990, failed not only to stimulate investments by lowering interest rates but also retarded them by dampening the growth of demand. Thus, it proved to be counterproductive because it focused on the wrong place. It paid attention to (dis)absorption and completely neglected competitiveness, which according to our analysis proves to be the real issue at stake. Units of production and technologically-based restructuring in particular, went backwards while at the same time the Greek economy rather than approaching the, even nominal, targets of the treaty of Maastricht, in fact diverged.

To counter the demoralising economic and social clima, a correct diagnosis needs to put problems into proper perspective. First of all, a
stable economic environment from a permanent and sustainable increase of GDP is certainly needed. Reinforcing the competitiveness of the economy should be considered as the top priority of the newly-elected government. Enhancing competitiveness would be immediately reflected in the balance of payments in a positive way by stabilizing the currency rate. Emphasis should be paid to increase investments in plant and equipments and this will certainly lead to higher rates of future productivity growth. Enterprises today desist from investment activities only partially because of high interest rates. In many countries, including the U.S., interest rates are quite low to encourage productive investments, but they fail to succeed the target. On the contrary, of cardinal importance seem to be expectations for future profits coming from a steady, permanent and proportionate to GDP, demand increase. Thus, restoring economic activity should be the first task of the government, while economy is in a permanent downturn. To break away from the persisting crisis, it is government's interest first, to raise the level of business activity and reduce the risks facing individual firms as they increase expenditure to stimulate recovery. Within this context, a general tax-based expansion is less sustainable because in an open economy, money seems to leak more to imports and consumer spending which creates only short-term and vulnerable jobs while it aggravates stagnation in the long-term. It would appear at least paradoxical, especially to conservative minds, right-wing policy-makers and "deficit hawks" that in order to reduce the deficit and the debt we may first increase them by a stimulus package directed on public investments, and spending on incentives to spur private investments in the intangibles, high-yield areas of training, education and research promotion to assist the economy in reaching the needed growth trajectory (Magaziner and Reich 1982, Reich
1992a, Wall Street Journal 1992). Such measures would stimulate demand, reduce unemployment, raise the GDP, and very likely raise private investment too. Recent studies which pay attention to these supply-side measures indicate that infrastructure spending both increases productivity directly and stimulates private investment (Baker and Schafer 1993, Aschauer 1990). Professor J. Tobin (1992, 1993) also argues that we should not be afraid to increase the deficit for investment purposes, and so to bring aggregate demand to a level which will permit us to enjoy full employment. Spending measures in infrastructure and investment tax credits are the two-track growth path for sustainable development (Blinder 1992). Thus, emphasis should be paid on microeconomic issues focusing on industrial policy in particular, both "horizontal", and "vertical". As far as it concerns the former, we repeat that general infrastructure investments would generate productivity increase of the private sector. For example, recent evidence shows that the Japanese have the highest public sector investment rate, and at the same time, their private-sector investment rate also exceeds that of the other nations (Ferleger and Mandle 1993). Similarly, A. Ashauer (1990), along with other numerous studies, has shown that the higher the public investments in infrastructure, the higher the productivity a nation enjoys, while any decline of public investment seems to go along with a slowdown and periods of recession. There is also evidence that there does exist a positive relation between total factor productivity and increase in tax revenues, especially those which come from personal and corporate income (Ferleger and Mandle 1993). The case of Japan is again an outstanding example. On the other hand, industrial targeting criteria should be applied to enforce country's comparative advantage and restructure private expenditures towards investment-led purposes.
(Krugman 1984, 1991, 1992). By enforcing industrial competitiveness it is very possible that we will succeed constant and permanent improvement in the trade balance and so, as a result, lead to international confidence over the national currency that will support an effective and real currency stability.

Policy directions proposed by this paper, share the view that in order to break away from the "vicious circle" and shift from speculative capital and generally unproductive activities to productive investments in the real economy, priority should be given to economic growth. Deficit reduction is only tangentially related. Over the long-term, a large deficit may retard growth, but it is not the biggest drug on growth (Reich 1992a, 1992b). Similarly, it is not wise to try to depress inflation at any cost in a slump era. Again, Greek economy neither was nor is - as believed - on the verge of overheating at present. If and when this changes it will be a good time to pump gently on the brakes. That time is certainly not today. If the newly-elected government will keep up conservative prescriptions, the results to come up in the future will be similar to those of the 1990-93 period.

Harvard University
REFERENCES CITED

Alogoskoufis, George
1991 Γιώργος Αλογόσκουφης, "Η Αξιοπιστία της Οικονομικής Πολιτικής". H Καθημερινή. 31 March.

Arsenis, Gerassimos

Aschauer, Alan

Association of Greek Industrialists
1992 Σύνδεσμος Ελληνικών Βιομηχανιών, Δεκέμβριος. Αντί προσωποποιημίως.

Baker, Dean and Schafer, Todd

Barkleys Bank

Blinder, Alan

Ministry of Finance
Central Bank of Greece

1992 Οικονομικό Δελτίο (1). Athens: CBG (Κεντρική Τράπεζα Ελλάδος)

Cohen, Stephen and Zysman, John


COM


Economou, George


Eisner, Robert


Epilogi

1993 Επιλογή, Jan-Febr.

European Economy


European Economy

1992 51. Brussels: EEC.

Eurostat


Ferlieger, Louis and Mandle Jay


Galbraith, James

Harrison, Benett and Bluestone, Barry


Heilbroner, Robert and Bernstein, P.


Krugman, Paul


1991 "Myths and Realities of U.S. Competitiveness", *Science* 254 (8 Nov.).


Kuttner, Robert

1992 "Don’t Worry so Much about the Budget Deficit". *Business Week*, 6 July.

Magaziner, Ira and Reich, Robert


OCDE


OCDE


OECD


OECD


OECD

OECD


Papademos, Loukas


1993 European Monetary Union and Greek Economic Policy in Greece, the New Europe,...

Pavlopoulos, Panayiotis

1986 Παναγιώτης Παύλουπολος, Εισαγωγικά Μεριδία Athens: IOBE.

1987 Η Παραοικονομία στην Ελλάδα. Athens: IOBE.

1989 "Φορολογία, Δημόσια Τομείς και Παραοικονομία. Μια Εμπειρική Ανάλυση” In Προτεραιότητας Δημοσιονομικής Πολιτικής, edited by George Protopoulos. Athens: IOBE.

Pavlopoulos, Panayiotis and Kouzelis, A.

1990 Παναγιώτης Παύλουπολος και Α. Κουζέλης, Το Δημοσιονομικό Πρόβλημα: Πολιτικά Athens: IOBE.

Pelagidis, Theodore


Reich, Robert


1992b "Accounting the Future" The American Prospect 11: 61-64

Spraos, John

Sweezy, Paul and Magdoff, Harry


Tobin, James


Vavouras, John

1993 ΕΣΩΤΕΡΙΚΑ ΒΑΣΙΛΕΙΑ, ΤΟ ΕΛΛΗΝΙΚΟ ΔΗΜΟΣΙΟ ΧΡΕΟΣ. Athens: Papazisis.

Vergopoulos, Kostas

1993 "Greece in the New European Order" in Greece, the New Europe,... Wall Street Journal

The Minda de Gunzburg Center for European Studies

The Minda de Gunzburg Center for European Studies is an interdisciplinary program organized within the Harvard Faculty of Arts and Sciences and designed to promote the study of Europe. The Center's governing committees represent the major social science departments at Harvard and the Massachusetts Institute of Technology.

Since its establishment in 1969, the Center has tried to orient students towards questions that have been neglected both about past developments in eighteenth- and nineteenth-century European societies and about the present. The Center's approach is comparative and interdisciplinary, with a strong emphasis on the historical and cultural sources which shape a country's political and economic policies and social structures. Major interests of Center members include elements common to industrial societies: the role of the state in the political economy of each country, political behavior, social movements, parties and elections, trade unions, intellectuals, labor markets and the crisis of industrialization, science policy, and the interconnections between a country's culture and politics.

For a complete list of Center publications (Working Paper Series, Program for the Study of Germany and Europe Working Paper Series, Program on Central and Eastern Europe Working Paper Series, and French Politics and Society, a quarterly journal) please contact the Publications Department, 27 Kirkland St, Cambridge MA 02138. Additional copies can be purchased for $4. A monthly calendar of events at the Center is also available at no cost.
Economic Policies in Greece During 1990-1993: An Assessment
by Theodore Pelagidis
Ph.D. Fellow at the Center for European Studies, Harvard University
and
SPES Researcher of the European Communities in the University of Paris VIII
(November 1993)
Working Paper Series #46

Abstract

This paper deals with the assessment of the economic policy followed during the period 1990-1993 in Greece. It analyzes in particular the evidence and the results of the applied conservative prescription at that time. While the results of this policy proved to be negative according to the arguments as well as the findings of this paper, a new policy agenda is sketched out. Proposed policy directions share the view that in order to break away from the economic crisis in Greece, priority should be given to economic growth, paying attention to public investments in infrastructure in order to generate productivity increase of the private sector, raise the level of business activity, and reduce the risks facing individual firms. A differentiated, selective and, according to market signals, gradual sliding of the national currency is this paper’s proposal for the crucial field of exchange rate policy.

*The author would like to thank the E.U. for its financial support through SPES funds. An oral version of this paper was presented at the Center for European Studies at Harvard University on November 30 and at the Fletcher School at Tufts University, Boston, on December 1, 1993. Comments from the audience are gratefully acknowledged as the source of improvements in this paper. Of course, the responsibility for the arguments presented remains mine.
INTRODUCTION

It is widely supported in Greece that excess demand and extremely high public debt and budget deficits constitute the main problems of the economy, responsible for the poor macroeconomic performance since the '80s and beyond. The conservative party which took power early in the '90s, facing intense macroeconomic imbalances, adopted at once a package of hard austerity measures in order to cut down the budget deficit and restrict domestic demand. The persisting economic crisis and the failure of sustainable growth were considered the outcome of past policies which had increased wages above inflation and productivity and promoted state intervention especially through the increase of unproductive public consumption expenditures. Three and a half year later, a political crisis provoked by the unpopular austerity measures, brings back to power the Socialist Party (Pa.So.K.), which as believed, will put an end to the "extreme monetarism" applied before. Despite this clearly declared intention, it seems that even within the socialist party, it is widely accepted that the government's new economic policy should, more or less, run on the same lines. Pro-socialist policy makers advise that general stabilisation measures, backed by a social concensus, are needed to bring the economy back to a stable macroeconomic environment. Carefully devised political movements and delicate words seem to be up to now the way of implementing and applying a "mild monetarist policy". Notwithstanding, it is unfortunate that few of the policy-makers who support conservative ideas even within the socialist party, present detailed and convincing arguments to justify the rationale behind the measures taken while, at the same time, this "ala mode" blind
devotion to a mania for austerity prevents them from keeping a cool head to evaluate the existing 3.5 year results of such a policy. In response to such an attitude, this paper makes an attempt to present and explain the goals and the rationale of the economic policy followed in the last three and a half year in Greece and more importantly, seeks to analyse the evidence and the results of this applied extreme monetary prescription.

1. Poor Macroeconomic Performance and Prevailing Diagnosis

It will not be news to anyone that the macroeconomic performance of the Greek economy during the '80s was not impressive. Real GDP grew at an average annual rate of 1.1% which is a low percentage both per se and compared to the GDP increase of the European Union (E.U.), around 2% (Spraos 1991: 1). Taking into account that Greece as a full member of the E.U. has both the obligation and the ambition to approach European standards, the increase in Greek GDP was rather disappointing. Despite periods of intense income restraints (1983, 1986, 1987, 1990), inflation proceeded at an annual average rate of 18% in the past decade. The current account deficit averaged -5.2% of GDP in the years 1980-1989, while the foreign currency debt increased from 10.6% in 1980 to 31% in 1989. At the same time, unemployment rose from 4% (1981) to 7% (1989), an almost double increase although still below the European peak rate of 11%. Industrial production remained almost stagnant - 0.8% average change during 1984-1991 - while the share of manufacturing production as a percentage of GDP retreated from 17.2% in 1975-1979 to 15.8% in 1985-89, facts which are both attributed to poor industrial productivity performance especially in the first five year period (-1.0% in 1980-84 and 2.4% in 1985-89).
The deterioration or at least the relevant stagnation of the main macroeconomic indicators is considered as a result of a huge public sector deficit which run at an average rate of 17.7% of GDP during 1984-91, and reached a record level equivalent to almost 19% in 1990, by far the highest level in the OECD area (Barleys 1993:12).

Since 1990, a year in which the conservative party took power, tough austerity measures have been taken with the goal of stabilizing the economy and bringing Greece closer to its European partners. Economic policy focused on the - believed - sources of macroeconomic disequilibrium: the huge budget deficits and the excess demand coming mainly from increases of wages above productivity during the last decade. Budget deficit, a concept familiar to economists, is constituted by the amount by which expenditures exceed tax revenues and regularly this amount must be borrowed or added to the total debt. Hence, debt is the sum of all past net borrowings. In the case of Greece, the applied neo-conservative analysis (Alogoskoufis 1990, 1991, Papademos 1989, Pavlopoulos 1986, 1989, Pavlopoulos and Kouzelis 1990, Economou 1991) attributes massive deficits to excess spending expenditures, referring in particular to excess public consumption and increase in private and public sector wages. Most of these expenditures are considered as a waste of resources which indeed provoke crowding-out effects in the private economy. As a result, nominal interest rates are going up so that the state may be able to pull capital resources in order to cover its deficits. One must remember that during the '80s the short-term nominal interest rates were at an average rate of 20%, a fact that, as it is argued, pulled resources away from private investment. On the other hand, excess domestic demand is considered to be the primary cause of high inflation as well as of the significant reduction of private sector profit rates which
had a negative side effect on investment decisions and, as a result, on productivity performance. Authors who support these arguments characteristically mention that public expenditures reached the unprecedented 49% of GDP at the end of '80s, fact which, together with excess public consumption rates, had negative effects on inflation as well.

In the reports of the influential conservative Institute of Economic and Industrial Research (IOBE), the enormous increase of the wage income share during the '80s, is particularly emphasized. Vice-director of the Institute Professor Economou (1991), points out that the income share of wages increased from 58.2% in 1981 to 66.8% in 1985, an increase which continued for the rest of the decade (1986-1989). The real wage in manufacturing increased cumulatively 4.4%, while productivity decreased -2.2%, having as a result a total net increase of the real wages for the whole decade of 16% (Economou 1991: 58 and : 72). G. Pavlopoulos (1986, 1989), Professor and Director of the same Institute and an advisor to the conservative government, estimates in detail the negative impact on profits due to an increase of real wages, a fact that is considered of cardinal importance for private investment decisions and hence for productivity increase and competitiveness. The same authors argue that real wage increase had a negative side effect to the marginal propensity to save, which from 22% of GDP in the '70s went down to 6% in 1987.

2. The Conservative Policy Perscription

Having supported the above diagnosis, the conservative government proceeded since 1990 to implement tough stabilisation measures focusing, in the first place, on efforts to reduce the deficit from 19% of GDP
(1990) to 3%, and the total debt from 76.3% (1989) to 60% (Epilogi 1993), so as to meet two of the most central convergence criteria of the Maastricht Treaty. Hence, to bring the economy closer to European standards, and to break away from the economic inertia provoked, as was believed, by the extremely high public sector borrowing requirements (PSBR), the conservative government announced a number of drastic fiscal measures. Besides a drastic overhaul of social security expenditures, higher indirect taxes and public utility prices were soon applied to increase state revenues and to compensate for the tax short-fall especially in the 1992-93 years, together with an urgent plan to de-nationalise state-owned enterprises like the cement company "AGET-Hercules", the Greek telecommunications corporation "OTE", shipyards, public transportation, etc. With the speeding-up of the privatisation process it was hoped that the state would get rid of public enterprises' deficits and get money from their sale so that the primary budget balance could show a surplus of 5% of GDP in 1993, rising to 7.7% until 1997. However, in the measures applied we should emphasize the corporate tax reduction to 35% and the personal income tax highest rate reduction to 40% (Barkleys: 6), in order to increase profits and as hoped, investments.

Shifting to the income policy, tough real wage cuts were adopted to diminish labour costs so as to decrease domestic demand and slow inflation. Pressuring demand and so keeping down inflation was considered as a precondition to cut interest rates and, as a result, state back payments and deficits. In fact, with inflation pressures persisting at the high levels of 15.8% and 14.5% the last two years 1992 and 1993 respectively, the public sector pay award of 5% in 1992 and 4% in 1993, brought down relative wage levels and did positively influence private sector profits. After tough real wage cuts in 1991-1993, payroll cuts are
expected to reduce the state wages bill from 12.4% to 11% of GDP by 1996 (Barleks 1993: 6).

As regards exchange rate policy, the scope was to keep the national currency within a very narrow range of fluctuation, around the ECU parity, with the prospect of entering the drachma into the European Exchange Rate Mechanism (ERM), as a first step of Greece's participation in the process of the European Monetary Union (EMU). Recent estimates put the overvaluation of the drachma at 20-30%, fact which has partly been the result of an anti-inflationary "crawling peg" policy in the last two years (Alogoskoufis 1993).

Finally, as for the liquidity of the economy, interest rates were supposed to enter in a process of gradual cut down by early 1994, along with a decrease of public debt. Money supply and credits to the economy also contracted. From 16.9% annual percentage change in 1990, credit expansion slowed to 10.8% and 9.8% in 1991 and 1992 respectively from its peak rate of 23.6% in 1989 (OECD 1993a: 60). M3 grew by 15.3%, 12.3% and 15% for 1990, 1991 and 1992 respectively, from 24.2% in 1989, following the same lines (op.cit.: 62). According to conservative policy-makers this would contribute to a drastic decrease of the liquidity of the economy, a fact which usually contributes to a deceleration of inflation and in a way counterbalances considerably liquidity issuing from the huge budget deficits and the massive debt.

Concluding the above policy prescription, we would say that during the years 1990-93, the conservative government adopted a total of tough austerity measures to slow inflation and to reduce the budget deficit. This type of irreconcilable monetarism was considered as the only way to succeed in the above goals, bring the country away from economic crisis, and also to meet Maastricht criteria. But other things are not equal. The
Maastricht treaty defines concrete nominal economic targets to be reached and sets deadlines for these to be achieved. It does not spell out the right policy to meet the goals. It is supposed to leave free ground to each member-State to apply the suitable policy prescriptions in order to succeed the targets, although the latter are subject more to political criteria and they are not designed according to purely economic logic. Notwithstanding, leaving aside the Maastricht treaty per se, we will make an attempt to assess the policy applied since the early '90s examining in the first place whether the government achieved the objectives set.

3. Results and Critical Assessment

Our first task is to consider the diagnosis for macroeconomic disequilibrium. Is it true that excess demand is found at the heart of the problem? It is reminded again that excess demand is believed to be created by extraordinary wage and public consumption expenditure increases during the decade of the '80s.

Contrary to what is commonly believed, during the '80s (1980-1990), the average annual change of total domestic demand in Greece was 1.3% (OCDE 1991), while the GDP per head grew at an annual rate of 1.7% during 1981-1991 (European Economy 1990: 239). Private consumption cumulative change in constant prices grew in Greece at 21% (1979-1989), while in the E.U. it grew at 24% in the same period (OECD 1991: 56). Private consumption in Greece was 51% of the community average in 1981, but dropped to 41% in 1991, a fact that we should attribute to the fall of the relative wage levels from 55-56% of the OECD and E.U. averages (in common currency) to 42-45% in 1991 (OECD 1993a:29). Therefore, as Vergopoulos (1991,1992,1993) rightly observes
the above evidence is highly incompatible with the overconsumption theorem and interpretation of crisis as perceived by conservative policymakers. On the other hand, Greece presents the highest saving propensity of households (around 20%) among the E.U. countries (14% average) (AGI 1992: 12-13), so we can certainly support that there is neither insufficiency of saving nor overconsumption tendencies at the expense of savings and investments. As for public consumption, although it is true that consumption grew constantly during 1980-89, it certainly remained at European levels, around 19% of GDP against 18.5% in the E.U. (OECD 1991: 66). The cumulative growth of real public consumption expenditures during the years 1982-1992 was 19.8% for Greece against 21.0% for the E.U. (OECD 1993b: 204). We should also mention that public expenditures as percent of GDP reached the European levels only in late '80s (around 50%), although what the state receives from the economy (around 35% of GDP) is far behind the European standards (45%), a fact which, according to our interpretation for the economic inertia today in Greece below, proves to be of cardinal importance.

The above evidence, which primarily refers to the excess domestic demand issue, is perfectly matched with the evidence concerning labor wages and costs. The real average wage per head grew in Greece at an annual average rate of 0.9% during 1983-90, while in the E.U it exceeded 1.5% (COM 1989: 60). The relative labour cost - per unit of product - in TABLE 3.1

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>GREECE</td>
<td>83.7</td>
<td>82.2</td>
<td>67.4</td>
<td>63.7</td>
<td>68.5</td>
<td>71.1</td>
<td>72.6</td>
<td>68.1</td>
<td>65.2</td>
</tr>
</tbody>
</table>

common currency, as can be easily seen by table 3.1 above, was 83.7 in 1984 of the European one, while in 1982 it fell off to 65.2%. Finally, Eurostat statistics show that, real wages in Greece are going down by 1.6% per year since 1985, while in all other E.U. countries real wages increased, from 2.8% in Germany - the higher % - to 0.7% in France - the lowest % (Eurostat 1992: 1).

After presenting and analysing so much data which deals with various aspects of the so-called "domestic demand" in the economy, we can definitely maintain that any problems of macroeconomic disequilibrium can not be attributed to excess demand, overconsumption and generally unproductive waste of resources coming from excess public or private consumption. We saw that, contrary to what is commonly believed, domestic demand was kept at low levels, in fact lower than the slight increase of GDP; public consumption and expenditures are at European standards showing convergence with the E.U. and not imbalance; at the same time, divergence is observed on state revenues and on wages, although the government in power during the '80s was a socialist one.

Let me now embark on the more complex issue of public debt and deficit, which, as mentioned above became the main concern of the policy-makers during 1990-93. As has been noted before, conservative authors still consider the annual public sector borrowing requirements (PSBR) as responsible for high inflation rates as well as for keeping interest rates up, a fact that it is commonly believed, pulls resources away from private economy and provokes dis-investment and crowding-out effects. I am not going to enter territory concerning theoretical issues about the relationship between interest rates and budget deficits, but I am almost urged to point out that government deficits do not necessarily
affect interest rates and investments. As Prof. Barro at Harvard University states clearly, government budget deficits do not necessarily affect interest rates, investment or anything else because the increase in private saving exactly offsets the fall in public saving. Along the same lines, we would say that the deficit affects interest rates only when the economy is near its potential level of output, which means that only from the point of full employment does it pull resources away from private investment. Deficit reduction stimulates investment through the freeing-up of resources only in the case in which the latter is not available. In any other case, problems are getting worse by excessive deficit reduction and we support that this is the case of Greece in the last three years or so. Gross household savings as a percentage of disposable income was 20.1% in 1991 in Greece and 14% in the E.U. (AGI 1992: 12-13). Therefore, the economy, despite high public borrowing, does have idle resources available indeed at such a level so that the view that private economy suffers from crowding-out effects can not be supported.

As I have cited before, contrary to the demoralizing syndrome about the wasteful, consumption-natured and unproductive Greek State, public consumption and expenditures do remain around the European standards. But if this is true, then what provokes the continuing increase of the total debt from the early '80s onwards, a fact that according to some academic analysts confirms "State hypertrophy" in Greece?

It is at first glance paradoxical that the highly restrictive policy adopted since the early 90s, while slightly reducing the PSBR at the same time massively increased the total debt, as you can realise for yourselves in table 3.2. But let us take things from the start. Looking at the composition of public expenditures and revenues one can easily realize why the debt explosion of 1990-93 can no longer be a mystery. As we can
see from table 3.3, public expenditures as a % of GDP have risen from 28.9% (1981) to 32.1% (1985), 37.5% (1988) and 47.8% (1992). Other

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>PSBR*</td>
<td>13.5</td>
<td>19.6</td>
<td>21.0</td>
<td>15.6</td>
<td>10.9</td>
<td>9.0</td>
<td>-</td>
</tr>
<tr>
<td>PSBR**</td>
<td>-</td>
<td>-</td>
<td>18.6</td>
<td>16.1</td>
<td>13.2</td>
<td>10.6</td>
<td>-</td>
</tr>
<tr>
<td>DEBT***</td>
<td>71.5</td>
<td>76.3</td>
<td>88.8</td>
<td>95.9</td>
<td>101.4</td>
<td>105.0</td>
<td>-</td>
</tr>
<tr>
<td>PSBR#</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>15-18</td>
</tr>
</tbody>
</table>

+Predictions, estimations.

Sources: *OECD (1993a: 51).

#While 1993 is ending, evidence announced just before submitting this paper, shows that the budget deficit for 1993 finally reaches 14-15%. Prof. L. Katseli, member of the council of economic advisors, person in charge of the 1994 budget report and personal advisor of the prime minister A. Papandreou, in a talk given in the Kennedy School at Harvard in November 1993, puts this number at 18%.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>28.95</td>
<td>37.53</td>
<td>43.65</td>
<td>47.81</td>
</tr>
<tr>
<td>Interests &amp; Amortization</td>
<td>-</td>
<td>8.56</td>
<td>11.91</td>
<td>9.92</td>
</tr>
<tr>
<td>Amortization</td>
<td>-</td>
<td>2.03</td>
<td>3.36</td>
<td>12.35</td>
</tr>
<tr>
<td>Primary expend.</td>
<td>25.21</td>
<td>26.95</td>
<td>28.38</td>
<td>25.54</td>
</tr>
</tbody>
</table>

reports like the European Economy (1990), raise the above number to 46.2% of GDP as average annual rate during the period 1981-1990. Whichever report is closer to the reality, one can easily realise that 46.2% is even lower than the relative E.U. rate of 48.0% - the average annual rate in the same period. Looking at the composition of public expenditures we observe that primary expenditures as a % of GDP remained relatively stable: from 25.2% in 1981, rising only to 28.38% in 1988 and dropping again to 25.5% in 1992. Thus, even this legitimate, according to European standards, increase of public expenditures since the early '80s is definitely not due to new/added primary expenditures. It is evident from table 3.3 that the increase arises from the explosion of interest and amortization payments which grew from 10.59% of GDP in 1988 to 22.25% in 1992. Total payments for interests and amortization as a % of public expenditures alone, also rose from 17.5% in 1988 to 42.2% in 1992 (Epilogi 1993: 24). To counterbalance the huge interest payment increases the share of wages and pensions in GDP - again contrary to what is commonly believed - decreased from 14.07% of to 12.45% in 1992. To cover the widening deficit, policy proceeded during

\[ \text{TABLE 3.4} \]
\[ \text{PUBLIC REVENUES AS % OF GDP} \]

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Indirect taxes</td>
<td>13.1</td>
<td>16.8</td>
<td>17.6</td>
<td>19.3</td>
</tr>
<tr>
<td>Direct taxes</td>
<td>6.1</td>
<td>6.9</td>
<td>7.7</td>
<td>7.9</td>
</tr>
<tr>
<td>Total tax revenues</td>
<td>19.3</td>
<td>23.8</td>
<td>25.3</td>
<td>27.2</td>
</tr>
<tr>
<td>Non-tax revenues</td>
<td>1.3</td>
<td>2.0</td>
<td>1.7</td>
<td>3.1</td>
</tr>
<tr>
<td>Total revenues</td>
<td>20.6</td>
<td>25.8</td>
<td>27.0</td>
<td>30.4</td>
</tr>
</tbody>
</table>

1990-93, to a large increase in taxes (revenue side). Total tax revenues increased from 22.3% of GDP in 1989 to 27.2% in 1992 (table 3.4). It is worth mentioning that this increase came mainly from indirect taxes (OECD 1993a: 50), while revenues from direct taxes shows only a 1% increase during this period, coming mainly from taxes on deposit interests (Ministry of Finance 1992). On the contrary, it is reminded that corporate tax was reduced to 35% (Barkleys 1993 :6). Despite indirect tax increase, Greece is still considered to be around the European levels (E.U. 19.0%), that is 19.1% of GDP for 1991 (AGI 1992: 12-13), although an important increase in indirect taxation with the measures taken in August 1992 should have slightly risen the figure.

Concluding from all of the above, two things are beyond any doubt. The existing big deficit should be attributed to a large extent to: a) the low level of state revenues, which were mainly a result of low direct taxes especially on incomes and profits. State revenues in Greece which come from taxation on incomes and profits constitute only 6.5% as a percent of GDP, while in OECD the correspondent figure is 14.5% (OCDE 1990: 141) and, b) to a serious increase of expenditures for debt service payments. Notwithstanding, in case we add to the official GDP the one that is produced in the so-called "atypic economy", and which is estimated around 30% (Pavlopoulos 1987), or even 50% of the official GDP according to Professor Angelopoulos and Barkleys (1993: 6) estimates, then state expenditures and revenues, as a % of GDP, are much lower than the official numbers indicate. Finally, at this point, it is worth mentioning that there are studies which indicate that this percentage should even be less when we estimate the inflation-adjusted PSBR (Spraos 1991) or when we modify calculations and leave aside state guarantees for private sector's borrowing or include state-owned corporation deposits in

Going back to the issue at hand, that is the assessment of the conservative monetarist policy applied in the last 3.5 years, we can now definitely support that the diagnosis was wrong. There is no way to support, as proved, that macroeconomic imbalances stem from either excess demand or a state that is, in size and intervention, consumptionist and wastefully hypertrophic. The deficit should not be considered structural since it is fed mainly by interest and amortization payments (expenditure side) and from the state's weakness, inability and unwillingness to impose and collect direct taxes (revenue side). The conservative government predicts a decrease of the deficit to 10% of GDP in 1993 (table 3.1), but even if this fall off comes true, total debt keeps increasing and will, even by optimistic predictions, exceed 105% of the GDP in 1993. On the expenditure side, we remarked that an ever increasing percentage goes for interest payments while primary expenditures remain stable. As long as the real rate of interest paid by the state remains higher than the real GDP increase, the debt will keep increasing for the foreseeable future. It is estimated that under these conditions it would need, from now on, high surpluses on the primary budget of central government in order to cover every "new" deficit coming from the deduction: real interest rates payments-increase of real GDP. But raising indirect taxes as well as efforts to cut spending in order to achieve a surplus in the budget excluding interest payments, it subtracts income from business and consumers, reducing even more purchasing power, profitability, consumer spending and investment (Galbraith 1993). Besides, high interest rates are not only kept artificially high in order to attract capital and compensate for low state revenues, but also because of
the need to prepare the national currency to formally enter the European Exchange Rate Mechanism (ERM) and keep up with Maastricht obligations regarding the creation of a common European currency (ECU) and so, as is believed, fight inflation. First of all, a high degree of exchange rate fixity requires correspondingly high levels of real interest rates, which further speeds-up the debt accumulation process both directly by increasing the interest payments on debt, and indirectly by reducing the demand for high-powered money and the growth rate of output (Papademos 1993: 153-154). Thus, this policy keeps the deficit at high levels and balloons debt, while at the same time, high interest rates hit the real economy and bring on economic inertia as the increase of GDP can not counterbalance high interest rate payments. Moreover, this has the result of an increase in the average rate of state services in order to cover the deficit, and it leads to an increase in prices and inflation. Inflation today remains around 15% and a recent tendency to fall by 2-3 points rapidly overturned by a need to increase taxes (from 22.3% of GDP in 1989 went to 27.2% in 1992) in order to cover an unexpected high deficit in the end of 1992. The fight against inflation does not take place neither by keeping the drachma parity high because a "hard currency" policy weakens trade balance. From -11.9 as % of GDP deficit in 1988, trade balance grew at -15.8 % in 1992 (OECD 1993a: 71) and thus, deterioration continues. While the trade deficit is growing, the artificial nominal drachma parity is seriously undermined, while sentiment about the drachma is dominated by the performance and prospects of the current account. Then, real parity falls off due to growing trade deficits, reinforcing market speculation over the national currency and keeping inflation at high levels, despite the fact that economy is in an unprecedented deep recession. This policy, combined
with excess disabsorption by highly restricting domestic demand, had as an outcome even more catastrophic results on the real/industrial economy. The fall off in domestic demand reduced the size of the domestic market and diminished economies of scale for enterprises, increasing the per unit cost - and furthermore boosting inflation once more. Enterprises, even those with much potential, find it always more difficult to compete in the international market arena when imports are subsidized via the undervaluation of the foreign currency while, at the same time, exports are taxed by an "expensive drachma". As a result, they find only one way to restore competitiveness through the Blustonian-Harrisian (1988, 1990) "low road restoration of profits" which is based on low wage labour force, and restores competitiveness in the short-term, but definitely undermines it in the long-term by lowering investments and preventing technological change (Cohen and Zysman 1987, Pelagidis 1989, 1993). It is estimated that only as a result of further wage cuts alone, there has taken place a sharp increase in Greek profitability of up to some 80% since 1990 (Barkleys 1993: 3), without actually increasing investment rates correspondingly (see table 3.5), contrary to what conservative policy-makers expected.

**TABLE 3.5**

**GROSS PRIVATE INVESTMENTS***

<table>
<thead>
<tr>
<th>YEAR</th>
<th>MIL. DR.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1985</td>
<td>56000</td>
</tr>
<tr>
<td>1989</td>
<td>64027</td>
</tr>
<tr>
<td>1990</td>
<td>73412</td>
</tr>
<tr>
<td>1991</td>
<td>65943</td>
</tr>
<tr>
<td>1992</td>
<td>64803</td>
</tr>
</tbody>
</table>

Source: OECD (1993a: 104). *In constant drachmas
The sharp increase in unemployment to 11% should also be considered equally damaging to the economy not only because this threatens social justice and destroys society's cohesion and social conditions for productivity increase, but also because it "represents" lost potential output. According to Professor R. Eisner (1993), high unemployment does not only mean waste of resources, as I have stated above, but also adds to the deficit in the short-term and the amount grows over time as additional deficit adds more to the debt and future interest payments. A loss of potential output means, furthermore, a loss in potential future investments which would increase productivity, competitiveness, having the side-effect of decreasing the debt and deficit by enlarging and deepening the taxable "base" of the economy and by increasing GDP. Thus, the potential deficit of the so-called "full employment budget", would be less. As a result, we can say that today's fiscal policy in particular is even more restrictive than it appears to be.

On the other hand, the healthy part of the Greek industry enjoys extremely high profit shares which exceed 60% although the relevant percent in the OECD and in the G7 countries is around 44% (OECD 1989: 124). Since 1990, there has also been a sharp recovery in Greek profitability, up some 80% as mentioned above (Barkleys 1993: 3). Direct state aid to manufacturing as a percent of value added was around 20% in Greece, while in the E.U. it was lower than 4% during 1986-90 (OECD 1993a: 16). Combining together at the same time, low taxation on business, low state revenues - coming from low taxation on incomes and revenues - high private profits, low investment rates and high public deficits, all these constitute a substantial state contribution to the private economy. This, "hidden" state back up to individuals as well as to
industrial competitiveness in particular, together with its low size and intervention to the economy, signifies in our view a particular "state atrophy" in Greece. It should be repeated and emphasized at this point that high interest payments by the state, in order to attract funds to counterbalance diminished budget revenues, constitutes in fact the way to feed private profits and makes the "crucial link" between the state and the private sector. This unique manner of state contribution substitutes today for the "old road" of state backing private revenues in Greece, namely the high state subsidies and general protectionism which took place in the era before Greek accession to the E.U. Significantly, this closed "vicious circle" of financial flows between state borrowing from the private economy through bonds, and the state back payments to it at high interest rates, in fact feeds speculative in nature capital which is not invested

TABLE 3.6

<table>
<thead>
<tr>
<th>SOURCES OF PSBR FINANCING</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
<tr>
<td>YEAR</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Internal borrowing</td>
</tr>
<tr>
<td>86.9  87.9  87.5  95.9</td>
</tr>
<tr>
<td>State Bonds purchased by:</td>
</tr>
<tr>
<td>Banks</td>
</tr>
<tr>
<td>42.2  16.1  1.8  -27.9</td>
</tr>
<tr>
<td>Individuals &amp; enterprises</td>
</tr>
<tr>
<td>18.9  43.1  68.0  93.7</td>
</tr>
<tr>
<td>Borrowing by commercial banks</td>
</tr>
<tr>
<td>15.8  13.7  12.7  -2.8</td>
</tr>
<tr>
<td>Bank of Greece</td>
</tr>
<tr>
<td>10.0  15.0  5.0  32.8</td>
</tr>
<tr>
<td>External borrowing</td>
</tr>
<tr>
<td>13.1  12.1  12.5  4.1</td>
</tr>
<tr>
<td>Total</td>
</tr>
<tr>
<td>100.0  100.0  100.0  100.0</td>
</tr>
</tbody>
</table>

*Jan-Sept, predictions

productively but instead contributes to the well-being of a "neo-compradoric" class which seems to live from interest revenues alone and at the expense not only of the agrarian and labour class but also of industry. In table 3.6 we have the opportunity to consider the economy's most serious problem which seems to lie in the increasing share of individuals and enterprises state bond purchase which reach at a peak level in 1992. This table shows that funds, instead of being directed to real investments on machinery and equipment - which increase productivity and competitiveness -, go to the purchase of state bonds simply because the latter are more profitable. Thus, industries learn to rely more on low wages, avoiding investments on new technologies and investing more, on state bonds (on speculation capital see: Sweezy and Magdoff 1987, Cohen and Zysman 1987, Bluestone and Harrison 1988, Pelagidis 1993).

Policy Guidelines and Conclusions

Intervening directly at the source of the problem is the main principle of economic policy. It is really unfortunate that in Greece, during the crucial years 1990-93 when a new policy was applied, the rule of optimal intervention was so much distorted by hitting domestic demand and creating excess disabsorption when the source of the problem was found in the supply side. Deficit reduction was the wrong criterion and target to use in the first place - not that it was unimportant, only that it was not the main issue. After 4 years of "wild monetarism", a slight decrease in the budget and current account deficit, together with some marginal decrease in the inflation rate since 1990 - in 1988 it was around 13% - constitute unimportant and only temporary improvements which
indeed took place at the expense of the industrial base of the country. As for the current account, it is estimated that for 1992 -2.7% of GDP from -4.7 in 1989 and -5.4% in 1990, although it was only -1.8% in 1988 (OECD 1993a: 71). As we saw before, within current account in non-oil trade balance in particular, which mainly reflects competitiveness (terms of trade non-included), things are getting worse. From -11.9 as % of GDP in 1988 negative non-oil trade balance grew at -15.0% in 1991 and -15.8% in 1992 (op.cit.: 71) and this deterioration continues mainly due to the hard currency policy. Indeed, deterioration would be even worse if imports were not hit by domestic demand restrictive policy. However, you can overvalue one, you can overvalue a bit more a second time but you can not keep extending overvaluation indefinitely without avoiding damages in the production sphere (Spraos 1991). Under a "hard currency" regime, it is indeed very possible that after a long period of recession, production could be so weak that it could not even respond to any increase of demand at that time. In that case, the most possible effect is that demand would be directed mainly on imports and then, trade balance will worsen even more. Authors who support "hard currency" policy believe that in any other case inflation will boost again, especially the "imported one" and then it would not be possible to bring down interest rates. We must mention at this point that:

a) it is very possible that in the case that we let the currency slide according to market signals, foreign competitors will keep prices down so as not to lose their domestic market share and,

b) by letting the currency find its true equivalence, we make exports more competitive and so increase production, thus compensating for the undervaluation and counterbalancing inflation expectations coming from it by enforcing production and improving trade balance.
Moreover, exchange rate parity should follow more closely the currency fluctuations of those countries which especially produce goods competitive to Greece, like Spain, Portugal and Ireland so we can efficiently support national competitiveness. Therefore, although exchange rate policy is a very delicate matter and a very sensitive one and thus careful movements need to be made, a selective, differentiated and gradual sliding of the national currency is what this paper proposes for the time being.

As for the budget deficit in particular, it becomes quite clear from our analysis that if the state keeps up paying real interest rates which exceed real GDP growth, any slight deficit decrease will be overbalanced by a deterioration in the total debt ratio. Our analysis proves that a large part of the deficit is traceable directly to the slow economy. Any effort indeed to reduce primary expenditures today would even worsen the current economic stagnation. However, an effort to restructure public expenditures on investment-led activities would be much preferable.

The policy followed since 1990, failed not only to stimulate investments by lowering interest rates but also retarded them by dampening the growth of demand. Thus, it proved to be counterproductive because it focused on the wrong place. It paid attention to (dis)absorption and completely neglected competitiveness, which according to our analysis proves to be the real issue at stake. Units of production and technologically-based restructuring in particular, went backwards while at the same time the Greek economy rather than approaching the, even nominal, targets of the treaty of Maastricht, in fact diverged.

To counter the demoralising economic and social clima, a correct diagnosis needs to put problems into proper perspective. First of all, a
stable economic environment from a permanent and sustainable increase of GDP is certainly needed. Reinforcing the competitiveness of the economy should be considered as the top priority of the newly-elected government. Enhancing competitiveness would be immediately reflected in the balance of payments in a positive way by stabilizing the currency rate. Emphasis should be paid to increase investments in plant and equipments and this will certainly lead to higher rates of future productivity growth. Enterprises today desist from investment activities only partially because of high interest rates. In many countries, including the U.S., interest rates are quite low to encourage productive investments, but they fail to succeed the target. On the contrary, of cardinal importance seem to be expectations for future profits coming from a steady, permanent and proportionate to GDP, demand increase. Thus, restoring economic activity should be the first task of the government, while economy is in a permanent downturn. To break away from the persisting crisis, it is government's interest first, to raise the level of business activity and reduce the risks facing individual firms as they increase expenditure to stimulate recovery. Within this context, a general tax-based expansion is less sustainable because in an open economy, money seems to leak more to imports and consumer spending which creates only short-term and vulnerable jobs while it aggravates stagnation in the long-term. It would appear at least paradoxical, especially to conservative minds, right-wing policy-makers and *deficit hawks* that in order to reduce the deficit and the debt we may first increase them by a stimulus package directed on public investments, and spending on incentives to spur private investments in the intagibles, high-yield areas of training, education and research promotion to assist the economy in reaching the needed growth trajectory (Magaziner and Reich 1982, Reich
Such measures would stimulate demand, reduce unemployment, raise the GDP, and very likely raise private investment too. Recent studies which pay attention to these supply-side measures indicate that infrastructure spending both increases productivity directly and stimulates private investment (Baker and Schafer 1993, Aschauer 1990). Professor J. Tobin (1992, 1993) also argues that we should not be afraid to increase the deficit for investment purposes, and so to bring aggregate demand to a level which will permit us to enjoy full employment. Spending measures in infrastructure and investment tax credits are the two-track growth path for sustainable development (Blinder 1992). Thus, emphasis should be paid on microeconomic issues focusing on industrial policy in particular, both "horizontal", and "vertical". As far as it concerns the former, we repeat that general infrastructure investments would generate productivity increase of the private sector. For example, recent evidence shows that the Japanese have the highest public sector investment rate, and at the same time, their private-sector investment rate also exceeds that of the other nations (Ferleger and Mandle 1993). Similarly, A. Ashauer (1990), along with other numerous studies, has shown that the higher the public investments in infrastructure, the higher the productivity a nation enjoys, while any decline of public investment seems to go along with a slowdown and periods of recession. There is also evidence that there does exist a positive relation between total factor productivity and increase in tax revenues, especially those which come from personal and corporate income (Ferleger and Mandle 1993). The case of Japan is again an outstanding example. On the other hand, industrial targeting criteria should be applied to enforce country's comparative advantage and restructure private expenditures towards investment-led purposes.
(Krugman 1984, 1991, 1992). By enforcing industrial competitiveness it is very possible that we will succeed constant and permanent improvement in the trade balance and so, as a result, lead to international confidence over the national currency that will support an effective and real currency stability.

Policy directions proposed by this paper, share the view that in order to break away from the "vicious circle" and shift from speculative capital and generally unproductive activities to productive investments in the real economy, priority should be given to economic growth. Deficit reduction is only tangentially related. Over the long-term, a large deficit may retard growth, but it is not the biggest drug on growth (Reich 1992a, 1992b). Similarly, it is not wise to try to depress inflation at any cost in a slump era. Again, Greek economy neither was nor is - as believed - on the verge of overheating at present. If and when this changes it will be a good time to pump gently on the brakes. That time is certainly not today. If the newly-elected government will keep up conservative prescriptions, the results to come up in the future will be similar to those of the 1990-93 period.

Harvard University
REFERENCES CITED

Alogoskoufis, George


1991 Γιώργος Αλογόσκουφης, "Η Αξιοπιστία της Οικονομικής Πολιτικής". Η Καθημερινή 31 March.


Arsenis, Gerassimos


Aschauer, Alan


Association of Greek Industrialists

1992 Σύνδεσμος Ελληνικών Βιομηχανιών, Δελτίο ΣΕΒ, Αύγουστος-Σεπτέμβριος.

Baker, Dean and Schafer, Todd


Barclays Bank


Blinder, Alan


Ministry of Finance

Central Bank of Greece
1992 Οικονομικό Δελτίο (1). Athens: CBG (Κεντρική Τράπεζα Ελλάδος)

Cohen, Stephen and Zysman, John

COM
Brussels: European Economic Community.

Economou, George

Eisner, Robert

Epilogi
1993 Επιλογή, Jan-Febr.

European Economy

European Economy
1992 51. Brussels: EEC.

Eurostat

Ferleger, Louis and Mandle Jay

Galbraith, James

Harrison, Benett and Bluestone, Barry


Heilbroner, Robert and Bernstein, P.


Krugman, Paul


1991 "Myths and Realities of U.S. Competitiveness", *Science* 254 (8 Nov.).


Kuttner, Robert

1992 "Don't Worry so Much about the Budget Deficit". *Business Week*, 6 July.

Magaziner, Ira and Reich, Robert


OCDE


OCDE


OECD


OECD


OECD

OECD

1993b *Economic Outlook 53 June*. Paris: OECD.

Papademos, Loukas


1993 European Monetary Union and Greek Economic Policy in *Greece, the New Europe,...*

Pavlopoulos, Panayiotis

1986 Παναγιώτης Παυλόπουλος, *Εισοδηματική Μερίδια*. Athens: IOBE.

1987 Παρασκευονομία στην Ελλάδα. Athens: IOBE.


Pavlopoulos, Panayiotis and Kouzelis, A.

1990 Παναγιώτης Παυλόπουλος και Α. Κουζέλης, *To Δημοσιονομικό Πρόβλημα Πολιτικής*. Athens: IOBE.

Pelagidis, Theodore


Reich, Robert


1992b "Accounting the Future" *The American Prospect* 11: 61-64

Spraos, John

Sweezy, Paul and Magdoff, Harry


Tobin, James


Vavouras, John


Vergopoulos, Kostas

1993 "Greece in the New European Order" in Greece, the New Europe,...

Wall Street Journal

The Minda de Gunzburg Center for European Studies
Harvard University

The Minda de Gunzburg Center for European Studies is an interdisciplinary program organized within the Harvard University Faculty of Arts and Sciences, designed to promote the study of Europe. The Center's governing committees represent the major social science departments at Harvard and the Massachusetts Institute of Technology.

Since its establishment in 1969, the Center has tried to orient students toward questions that have been neglected both about past developments in eighteenth- and nineteenth-century European societies, and about the present. The Center's approach is comparative and interdisciplinary, with a strong emphasis on the historical and cultural sources that shape a country's political and economic policies and its social structures. Major interests of Center members include elements common to industrial societies: the role of the state in the political economy of each country, political behavior, social movements, parties and elections, trade unions, intellectuals, labor markets, and the crisis of industrialization, science policy, and the interconnections between a country's culture and its politics.

For a complete list of Center publications (CES Working Paper Series, Program for the Study of Germany and Europe [PSGE] Working Paper Series, Program on Central and Eastern Europe Working Paper Series), please contact the Working Papers Series office, CES, 27 Kirkland Street, Cambridge MA 02138 (e-mail: bouliane@fas.harvard.edu). Papers may be purchased for $5.00 each (plus postage to non-U.S. addresses). A monthly calendar of events at CES is also available on the Web at http://www.fas.harvard.edu/~ces.