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REVISED CONVERGENCE PROGRAMME FOR THE GREEK ECONOMY 1994-1999

AN ASSESSMENT

(Note for the attention of the Monetary Committee)

Με τους χαιρετισμούς μου

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I. INTRODUCTION

In February 1993 Greece presented a convergence programme which was discussed by the Monetary Committee at its meeting on 1st March 1993 and by the Eco/Fin Council on 15th March 1993. Subsequently as a result of a very significant overrun in the fiscal targets for 1993 it was clear that the convergence programme, without significant revision, was no longer valid. This was accepted by the new Greek government who have prepared the present revised programme covering the period 1994-1999.

Up to the present, analysis of the Greek economy has been based on the Greek national accounts based on 1970 prices and national definitions. A technical programme with the assistance of the Commission's Statistical Office and with Community funding has recently established new national accounts for 1988 on an ESA basis. Using these accounts the Greek Ministry of National Economy has drawn up an estimated set of national accounts for the period 1988-1993. These accounts reveal much higher levels of GDP (±20%) than under the old 1970 SNA based accounts. The convergence programme, using the 1988 based accounts, is established on a 1993 price basis which, however, appears to involve some substantial changes in the structure of output and demand (Annex Table 1)[1].

II. MAIN FEATURES OF THE PROGRAMME

The objective of the programme is that by 1998 the Greek economy will satisfy all the nominal convergence criteria set in the Union Treaty, ensuring the full participation of the country in the third stage of EMU from 1999. Inflation will decelerate, from 10.8% in 1994 down to 3.3% in 1999. The net borrowing of general government will represent 0.9% of GDP in 1999 and the debt ratio, after successful stabilisation in 1996 at 115.3% of GDP, will be reduced by around 12% points of GDP by 1999. At the same time, faster real output growth particularly in the final years of the programme will enable real convergence to be resumed.

Underlying these expectations are: the correction of fiscal imbalances, through the improvement of revenue performance and the rationalisation of expenditure; a restrictive monetary and exchange rate policy in the framework of the capital market liberalisation on May 16, 1994; and an economic development policy based on the improvement of economic infrastructure and of the institutional framework of economic operators. Table 1 presents the main characteristics of the convergence programme:

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1 Since the Commission and the Greek authorities are moving or have moved to the 1988 based ESA accounts, technically it will be difficult to monitor the growth rate of GDP in price and volume terms in the convergence programme as the assessments of the Commission and the official Greek data will be on a different accounting basis. In the following assessment these accounting problems are ignored and the convergence programme is treated as presented.

TABLE 1

Features of the Convergence Programme

	1994	1995	1996	1997	1998	1999
Real GDP growth	1.1	1.2	1.7	2.6	3.0	3.5
Inflation (private consumption deflator)	10.8	7.9	6.1	3.9	3.5	3.3
Current account balance (%GDP)	-2.9	-2.5	-2.2	-2.0	-1.8	-1.8
Net borrowing of general government* (% GDP)	13.2	10.7	7.6	4.2	2.4	0.9
General government debt (% of GDP)	112.1	115.2	115.3	113.4	109.3	103.4

* Excluding privatisation revenues

The programme, while covering the period 1994-1999, can be seen to be divided into two sub-periods; the first covering 1994-1996 is a period where fiscal adjustment receives the main emphasis and the second period is one in which, on the basis of the significant fiscal adjustment achieved in the first period, the economy begins to grow and to catch up. Thus the programme embodies both nominal and real adjustment.

- <u>During the first period</u>, inflation declines by 4.7% points, from a projected 10.8% in 1994 to 6.1% in 1996. As a result, interest rates on government borrowing decline at a rapid pace, by almost 8% points; however, because of the rising debt ratio during this period, actual interest payments decline by only 2% points of GDP, to 11.9% of GDP in 1996. The consolidation of public finances progresses through the realisation of a primary surplus, reaching 4.4% of GDP in 1996, mainly due to increased revenues (3.4% points of GDP). General government net borrowing is reduced to 7.6% of GDP in 1996 or 7% after taking account of privatisation revenue. As real interest rates are expected to remain relatively high, due to the high borrowing requirement of the government, private investment will recover at a slow pace which, combined with the impact of fiscal adjustment on domestic demand, will lead to an overall rate of growth in real output of 1.3% on average. During this period, however, public investment rises considerably (by 7.8% p.a.) offsetting the projected reduction in public consumption.

- <u>During the second period</u>, 1997-1999, fiscal consolidation progresses further while economic activity recovers. Real output growth accelerates, averaging 3% and disinflation progresses further albeit at a slower pace. The continuing declining trend in nominal interest rates and in the debt ratio result in a fall in interest payments of almost 5% points of GDP; a primary surplus of 6.1% of GDP is achieved at the end of the period; as a result, general government net borrowing declines by 6.7% points of GDP, from 7.6% of GDP in 1996 to 0.9% of GDP in 1999. Due to fiscal adjustment, and to more favourable inflation expectations, real interest rates decline further, boosting private investment while public investment continues to rise. Economic activity recovers through the reorientation of spending from consumption to investment.

These results are to be achieved through tight monetary and fiscal policies on the one hand and a development policy centered on investment on the other. Fiscal adjustment is to be achieved largely through an enhanced revenue performance. The assumptions of the programme are that the series of revenue measures already introduced in 1994, to implement the budget and to tackle tax evasion, will produce significant revenue results in 1994-1996 so that the revenue share of GDP will rise from 1993 by over 4 percentage points (to 38.1% of GDP in 1996). The measures consist of raising tax rates (e.g. on tobacco) new taxes (e.g. an 8% procurement tax on public sector purchases) and a wide range of measures to tackle evasion which will mostly impact on the 1995 and 1996 budgets[2]. The sale of shares in publicly owned companies is expected to yield Drs 150 billion p.a. over the period 1994-96. In addition, reforms of the budgetary process and of the Ministry of Finance are aimed at improving budgetary performance. Thus expenditure is expected to be brought under better control and scrutiny and public consumption is expected to fall by 0.5% p.a. A public sector incomes policy and limits placed on recruitment will help to limit current expenditure.

Monetary policy will be oriented to a reduction in inflation aided in the first period by the already agreed incomes policies in the public and private sectors. Inflation will be kept on a downward trend leading to falling interest rates through the course of the programme. The efficiency of monetary policy will be aided by continuing reforms and development of the money and capital markets. It is expected that these combined with the already introduced full liberalisation of capital will help to attract foreign investment while the reduction in the fiscal deficit will ease the capital market conditions for private investors.

The second major feature of the programme is the emphasis on development policies. These are centred on investment with public investment taking the leading role in the first period to be followed subsequently by a more dynamic private investment. Public investment will be aided by the Structural Funds, the plans for which have been designed to maximise "production restructuring" through upgrading of the economic and human infrastructure. Further measures to tackle unemployment, strengthen SMEs and increase support for exports, especially to the Balkan and Black Sea areas, are proposed. The floatation of shares of public companies is expected to be associated with increased competitiveness in these undertakings.

III. ASSESSMENT

The revised convergence plan puts a welcome emphasis on the need for fiscal adjustment and the need to enhance the efficiency of the economy. Compared to the original convergence programme it has a more realistic projection for economic growth, in particular in the early period when significant fiscal adjustment is assumed. There are, however, a number of areas where doubts may be raised about the realism of the programme. In particular the assessment of the fiscal situation in 1994 looks optimistic

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2 Law 2187/94 implements the tax increases and other measures in the budget; law 2198/94 deals with tax arrears and law 2214/94 contains a wide range of measures to improve tax compliance and fight evasion.

while the assumed profile of fiscal adjustment over the course of the programme raises a number of questions including the extent to which the measures outlined in the programme are sufficient to achieve the expected results.

The outlook for 1994

While the growth picture presented by the programme for the period as a whole could be seen to be realistic, the Commission has a somewhat more pessimistic assessment of the growth of output and demand in the early years 1994 and 1995.Thus the Commission's Spring forecast for growth in 1994 and 1995 is 0.7% and 0.9% compared to the convergence plan forecasts of 1.1% and 1.2% while for domestic demand the respective figures are 0.8% and 1.1% in the Commission's forecast and 1.4% and 1.4% in the convergence plan. In themselves these differences are not large, but against a background of fiscal slippage the weaker domestic demand picture forecast by the Commission contributes to a more pessimistic view of the expected 1994 fiscal outturn.

With respect to fiscal policy, analysis is made difficult by the changes in the accounting framework and presentation of data by the Greek authorities (Annex Table 3). Thus the convergence programme deficits for 1993 and 1994 are not the same as those reported under the excessive deficit procedure (while the Commission's own estimates, based on the old SNA national accounts, are for higher general government deficits in both years than either of the Greek sources). Up to the present the Commission has not been able to reconcile the various presentations of the fiscal deficit including the transition from budgetary accounts to national accounts. For this reason, and also because current data are only available on this basis, the Commission's analysis is based on the budgetary accounts[3].

The convergence programme would appear to accept that there will be some fiscal slippage in 1994 most of which will be covered by privatisation revenues which were not included in the 1994 budget. However the Commission's assessment is that the overrun in the 1994 budget deficit will be larger than allowed for in the Greek convergence programme.

In the first 6 months of 1994 ordinary budget revenues rose by 10.5% well short of the budget requirement of a 22.2% increase. The weakness in revenue growth continues a trend which emerged in the previous year when ordinary budget revenue fell short of the target by Drs 980 billion (4.7% GDP). Behind these trends lie excessive optimism in budgetary estimates, a weak economy, miscalculation of the impact of tax reforms, problems in the collection of VAT and the impact of the autumn election. More recent data indicate some improvement in the collection of revenue and in particular what could well be a normalisation of VAT returns. Nevertheless, it is now clear that 1994 will again see a significant shortfall in central government revenues. If revenue were to rise by 17% in the second half of the year compared to the 10.5% achieved in the first half, the shortfall would amount to Drs 400 billion (1.7% GDP).

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[3] Where necessary these have been converted into proxy national accounts terms by adjusting the budgetary accounts to a national accounts basis by adding capitalised and other excluded debt servicing costs and converting to a general government basis by adding the social security and local autnorities balances using the excessive deficit procedure reported data for these accounts.

There are also risks on the expenditure side. The most significant concerns the impact of the recent exchange rate pressure on debt service costs. The budget estimates had been built on the assumption of lower interest rates (a 12-month Treasury Bill rate of 18.5%) which, in fact, had been achieved over the early months of this year (Table 5 Annex). However, in the second half of May as pressures emerged on the Drachma, interest rates rose dramatically and the authorities experienced some difficulty in meeting their financing requirements. A one month zero coupon instrument was issued at 27% in May and a one month Treasury Bill at 25.5%. Interest rates have subsequently fallen back but they remain higher than the assumptions underlying the budgetary forecast for debt servicing costs; at end-July the one year Treasury bill rate was set at 20%.

In response to these difficulties the authorities turned to foreign borrowing and to foreign currency denominated borrowing on the domestic market which, despite liberalised capital movements and high spreads is cheaper than Drachma financing. Clearly this is a strategy which can only be temporary and contains an element of risk. Already in 1993 there had been a significant rise in the recourse to foreign borrowing to finance the fiscal deficit. In addition, in the early months of this year financing costs had been reduced by a switch from Treasury bill financing, where the interest cost is paid in advance, to bond financing where interest is paid at the end of the coupon period. This too is an uncertain factor which could easily be reversed. Thus while it may be possible for the authorities to contain their debt servicing costs within the budgeted provisions there are significant risks which, if realised, could in turn create problems in 1995.

In addition to debt servicing problems pressures are likely to emerge on grants and subsidies to the wider public sector. These are forecast to increase by 7½% in the budget well below the rate of inflation and the increase in wage rates. The authorities are also restraining the rise in administered prices in order to keep inflation low and this will also put pressure on the budgets of the wider public sector institutions. Furthermore, the government has imposed an 8% procurement tax on purchases by the central government and the wider public sector and this is likely to raise costs as undoubtedly the tax will, at least partially, be passed on. Finally higher interest rates will increase the debt servicing costs of the wider public sector. For all these reasons there is a risk that the budget estimates for grants and subsidies will prove too low and the deficits of the wider public sector, which are financed by the central government through grants and subsidies, will be larger than expected.

On the other hand, there are indications that investment expenditure may fall short of target and that tight control of other primary expenditures will help to keep the expenditure side on track.

In sum, there will undoubtedly be a significant shortfall in revenue again this year. This could be partially covered by share sale revenue and by a shortfall in investment expenditure. However, there are substantial risks to the 1994 budget which if they were realised would imply that large scale measures would be required in the 1995 budget if the general government deficit target of the convergence programme (10.7% GDP before privatisation revenues) is to be met.

The profile of fiscal adjustment.

The table below indicates the profile of adjustment outlined in the programme. It can be seen that practically all of the adjustment in the fiscal deficit over the period of the programme (11.6% GDP) is explained by an increase in revenue (+6.6% GDP) and a fall in the costs of servicing the debt (-5.3% GDP). Overall primary expenditure does not contribute to fiscal adjustment although within the primary expenditure total current expenditure falls (-2.1% GDP from 1993 to 1999) while investment expenditure rises (+2.3% GDP).

TABLE 2

The profile of fiscal adjustment 1994 - 1999

% GDP

	1994	**1995**	**1996**	**1997**	**1998**	**1999**	**Total**
change in : *							
net borrowing	+0.7	-2.5	-3.1	-3.4	-1.8	-1.5	-11.6
ordinary revenue	+0.7	+2.0	+1.4	+0.2	+0.1	+0.1	+4.5
net capital receipts	+0.3	0	+0.2	+0.4	+0.5	+0.7	+2.1
primary expenditure	+0.1	-0.1	0	0	+0.1	+0.2	+0.3
interest costs	+1.6	-0.3	-1.7	-2.6	-1.5	-0.8	-5.3

* Figures may not add due to rounding

On the expenditure side all the adjustment comes through a fall in the interests costs of the debt. This is explained by the programme's forecast fall in inflation leading to falls in nominal and real interest rates. Thus the programme assumes that inflation falls steadily through the programme from 10.8% in 1994 to 3.3% in 1999. This is matched by an assumed even faster fall in the Treasury bill rate from 18.5% in 1994 to 6.2% in 1999 and it is this fall in interest rates combined with revenue growth, which produces all of the fiscal adjustment.

The realism of these assumptions may be questioned. As in other countries, inflation in Greece is influenced by external factors, wage developments and the fiscal deficit all of which impact on inflation both directly and through their impact on inflation expectations. In recent years tough wages policies have contributed to the fight against inflation in Greece as also has the (relatively) hard exchange rate policy (see below). However, fiscal deficits have remained high and through 1993 and the first half of 1994 the deficit has been rising. This could slow the decline in inflation which has recently been seen in Greece. Indeed inflation has flattened out at just under 11% in recent months and it is uncertain if the deceleration will be resumed. Without fiscal adjustment, tight incomes policies and a hard exchange rate policy could have only partial effects in stopping the rise in inflation and if the fiscal adjustment in the programme was not realised the beneficial inflation and interest rate scenario would be unlikely to be realised. Against the background of the fiscal slippage in 1993 and the continuing weak fiscal performance in 1994 the inflation forecast of the programme could prove unrealistic.

Similarly the interest rate paid on government debt is determined by the markets which are influenced not only by the rate of inflation but also by the extent of the government's financing requirements and above all by the credibility of the government's policies. While effective and credible action to reduce the deficit will undoubtedly lower the cost of the debt in nominal and, ultimately, in real terms it is dubious if interest rates can lead the adjustment process. Furthermore the existence of complete capital liberalisation could well lead to an enhanced interest rate premium on the Drachma. Indeed, as the convergence programme notes, interest rate policy is now determined by the exchange rate policy and achieving a lower level of interest rates will require sustained measures of adjustment if credibility of policy is to be achieved vis-à-vis the markets.

The second factor in the adjustment process is a significant rise in current revenues with the revenue share in GDP rising by 4 points in 1993-1996. As indicated in the table the revenue elasticities rise sharply, particularly for direct taxes, before returning to more normal values in 1997-1999.

Table 3

Implicit revenue elasticities in the Convergence Programme

	1994	1995	1996	1997	1998	1999
Indirect taxes	1.3	1.3	1.4	1.1	1.0	1.0
Direct taxes	1.3	2.7	2.5	1.1	1.0	1.0
Total revenues	1.2	1.7	1.5	1.1	1.0	1.0

This somewhat unusual revenue profile comes from the implementation of recent measures. As described in the convergence programme these are the laws which implement the 1994 budget, deal with tax arrears and reinforce the fight against tax evasion. These measures are presumed to have a very significant impact on budget revenues although there is no specific quantification of the effects of the various proposals other than the tax rises contained in the budget. What should be noted is that these measures are not uniquely concerned with raising revenues but also increase tax reliefs. The main relief granted in law 2214/94 is that tax payers can now claim against income for tax purposes documented living expenses of up to a maximum of 30% of Drs 1.000.000. This reverses (partially) the tax reform of 1992 which was concerned to eliminate the plethora of allowances and deductions against tax in return for much lower tax rates. The result will be a loss of revenue. There are no official estimates although a loss of Drs 60 billion (0.2% GDP) in 1995 has been suggested. The other measures have to more than offset this loss in order to achieve the rather substantive impact assumed in the convergence programme. If the normal elasticity of revenue to GDP is assumed to be unity then the convergence plan would appear to imply that the revenue gain from the anti-evasion measures would amount to about Drs 530 billion in 1995 (2.1% GDP) or Drs 590 billion after taking account of the tax relief. This sum is more than the entire income tax revenue from households and is more than 70% of income taxes on households and corporations (1993)[4]. Such sums have never successfully been raised in the past by anti-evasion measures and doubt may be expressed as to whether the measures taken in 1994 could yield such results.

The convergence plan refers to a reform of the Ministry of Finance with the aim of increasing the efficiency of tax collection. It is to be hoped that these reforms will take account of the advice of the technical assistance mission of the IMF on tax administration and of the results of the joint Commission/Greek working party on VAT administration shortly to be presented to the Greek authorities. It should be noted that the Community is proposing to finance a modernisation programme for the Greek public administration with the Community Support Framework including the modernisation of the administration of the public finances.

Monetary Policy

The main target of the Greek convergence programme is a rapid reduction in the rate of inflation. In addition to fiscal and income policies, monetary policy has to play a prominent role in the process of disinflation. To this aim the Bank of Greece has adopted two intermediate targets: the rate of increase in M3, and exchange rate policy, which keeps the rate of depreciation of the drachma below the expected inflation differential with Greece's main trading partners. After the full liberalisation of capital movements in May 1994, the exchange rate became the most important monetary policy target.

Aggregate targets

In 1993, the Bank of Greece failed to meet its monetary targets, M3 increased by 15.2 % against a target range of 9 % to 12 %. The 1994 monetary programme provides for an 8 % to 11 % target for M3; the 12-month increase in April was at 16.2 %. The targets and outcomes for the main aggregates are summarised in the following table:

[4] Most of the measures in law 2214/94, the principal anti-evasion law, relate to direct taxes.

TABLE 4

Monetary programme: Targets and outcomes, 1993 and programme 1994 (% changes)

	1992		**1993**		**1994**	
	target	**outcome**	**target**	**outcome**	**target**	**April 94**
M3*[1]	9 - 12	14.4	9 - 12	15.2	8 - 11	16.2
Total Domestic						
Credit Creation	7 - 9	8.5	6 - 8	13.1	6 - 8	10.7
Private Sector	14-16	17.1	13-15	12.2	11	12.7
Public Sector		3.8	5 - 7	13.5	3.7-6.6*[2]	9.7
M4		19.2		16.9		16.1
PSBR (%GDP)		10.2		13.1		

*[1] new definition, which includes repos and bank bonds
*[2] Implicit target

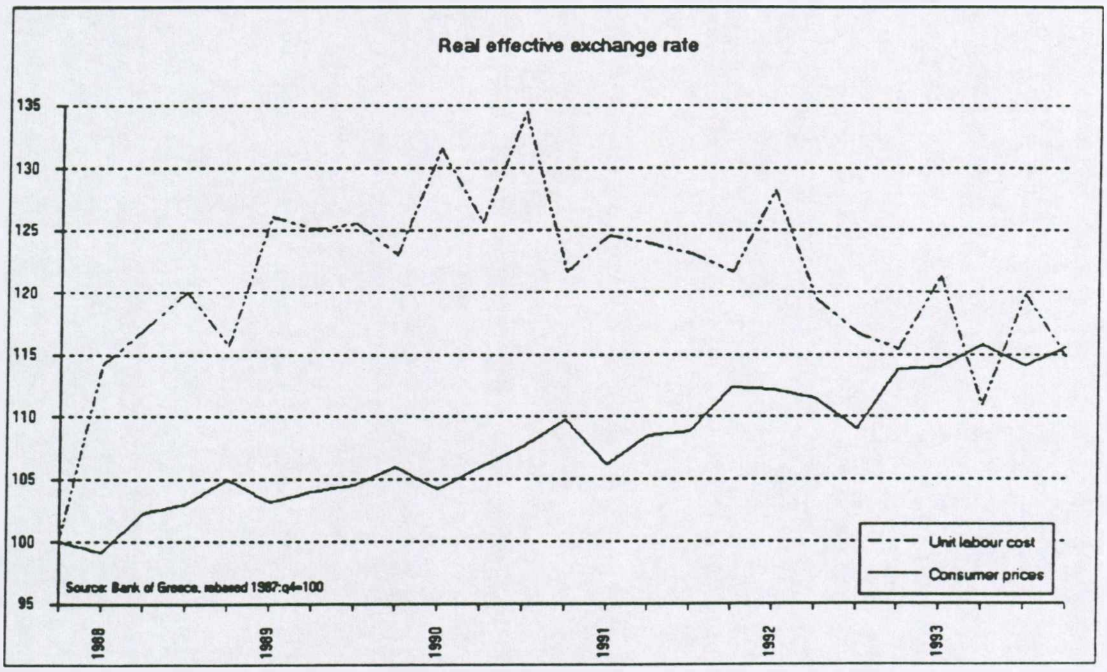
Given the liberalisation of capital movements in May, it has potentially become much more difficult for the Bank of Greece to influence monetary aggregates and at the same time to pursue the given exchange rate policy. Nevertheless, aggregates can still provide valuable information about inflationary tendencies and hence about the appropriateness, from the point of view of the short-term inflation objective, of the exchange rate path. The overshoot might, on the face of it, imply a higher exchange rate path. However, this would probably be unsustainable in market terms. This highlights the inconsistency between the paths of monetary and fiscal policies.

In 1993, M3 grew outside the target range mainly due to the overshoot in the public sector borrowing requirement (PSBR on a cash basis). An additional factor was the much smaller share of sales of treasury bills and government bonds to the non-bank private sector. The market seems to have reached a degree of saturation that does not allow an expansion of sales of government paper on domestic markets at current interest rates. Reportedly, recent issues of public paper were not well received in domestic markets. The financing of the cash PSBR has changed significantly between 1991/92, when more than half of the public debt was bought by domestic non-banks, and only about 8 % was direct foreign borrowing by the public sector. In 1993, external financing accounted for 28 % and the share of net sales of government debt to resident non-banks fell to 38 %.

Exchange rates

The crawling peg strategy, which does not allow for the full inflation differential, as measured by relative consumer prices vis-à-vis the country's EC partners has been in place (if only implicitly) since 1986. In terms of consumer prices there has been a slight but steady real appreciation of the drachma of around 2.5 % in each year, since the first quarter of 1986; however, against other 'Mediterranean' currencies[5] (the LIT, PTA, and ESC) the real appreciation of the drachma in 1993 has been more than 10 %.

In contrast, in terms of unit labour cost there was an improvement in competitiveness of some 2 % in each year, since 1990. Nevertheless, the real effective rate in terms of unit labour cost is still almost 20 % above its level at the end of 1987. A closer look at inflation developments reveals that the rate of price increases was significantly higher in the sheltered sector than in the sectors which are open to foreign competition. This might indicate that profit margins in the export sector are squeezed with potentially detrimental effects on the supply side and long-run growth prospects: resources are pulled into production for domestic (consumption) demand.



In May 1994, the drachma was under significant market pressure, and the Bank of Greece had to hike short-term interest rates to very high levels, around the time of the bringing forward of full capital liberalisation. Subsequently, interest rates gradually declined, and market pressures on the drachma have eased. Nevertheless, the event has shown that the defence of the drachma, might at times involve a level of interest rates which is a heavy burden for the budget. Overnight interbank rates, which were at 68.7 % on average in May have declined to 18.5 % by mid-July, a level slightly below the pre drachma crisis level. However, 12-month rates for government paper, which are set by the Ministry of Finance, remain significantly higher, 20% at end-July against 18.5 % in May.

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5 The deterioration of competitiveness was even larger against the Turkish Lira.

Development policies

The second major element in the convergence plan consists of measures for the development of the economy. These are centred on investment and include not only the re-allocation of expenditure within the Community Support Framework but also the revision of the incentives system for attracting foreign investment and strengthening the competitiveness of the public enterprises.

While the emphasis on investment plans in both infrastructure and human capital is understandable there is a lack of emphasis on the need for reform. Thus according to the new national accounts Greece already has an adequate level of investment 1.75% of GDP above the Community average in 1988-93. The outstanding feature in Greece is not so much a low level of investment but the very low level of output that investment generates. This would suggest that much stronger emphasis would need to be put on reforms in the productive system including the labour and capital markets, the wider public sector which, in Greece, is responsible for a significant part of national output, and in the public administration. It is likely that reform in these areas is a precondition to a successful investment drive.

IV. CONCLUSIONS

The revised programme can be welcomed on two grounds. Firstly, it aims to meet the requirements for participation in EMU before the end of the decade. It explicitly recognises that effective action to tackle the fiscal and debt problems is essential if the objectives of nominal and real convergence are to be achieved and it proposes a significant reduction in the fiscal deficit over the course of the next four years with debt stabilisation to be achieved by 1996. Secondly, the plan is built upon a macroeconomic forecast which is more modest and realistic than its predecessor (Annex Table 4). The relatively subdued growth rate in the early years of the programme reflects the planned fiscal correction while growth builds up slowly over the course of the programme.

However there must be considerable doubt about the logic of fiscal adjustment proposed in the programme. On the basis of existing measures, credibility and the benefits therefrom are ascribed to the fiscal situation straight away with interest rates falling significantly from the start so that debt servicing, which is at the heart of the adverse fiscal dynamics in Greece, is stabilised in GDP terms and falls rapidly thereafter. This is an unlikely scenario and one which is not matched by the experience in other countries. Normally, significant primary adjustment must be achieved before credibility gains accrue in the adjustment process. Against the background of a high and rising fiscal deficit it is difficult to believe in the benign scenario of the programme.

Furthermore, the fiscal adjustment outlined in the programme is unlikely to be achieved without substantial extra measures. Thus while the proposed rise in fiscal pressure (4% of GDP in the period 1993-1996) could be feasible, given Greece's low tax ratio, there must be considerable doubt that this could be achieved on the basis of the measures proposed. Previous experience with budgets based on large scale revenue gains from fighting evasion would not lend certainty to the estimates in the convergence programme. There are no back-up measures in the convergence programme or indications of what the government would do if the revenues do not materialise.

The planned expenditure adjustments would also appear to be inadequate. It is difficult to believe that significant fiscal adjustment (11.6% GDP) can be achieved without deep expenditure cuts. This is even more the case if a policy of expanding public investment is to be pursued.

Greece is a country where extensive reform would appear to be essential to the development process. Increased investment, particularly from the public sector cannot be effective if reforms do not take place. In Greece, reforms are urgently required in the public sector including all the productive enterprises if public investment is to be efficient and there must be some room for doubt as to whether the emphasis in the convergence programme on increased public investment as a central dynamic in the development process is adequately matched by proposals for reform.

Finally, there are significant risks that this revised convergence programme will suffer the same fate as its predecessor which went badly off track with respect to the fiscal deficit right from the starting year. While there is a great deal of uncertainty about fiscal revenue in Greece, and this has been a characteristic of recent years, there is a risk that there will be a substantial shortfall in 1994 and it is uncertain if share sale revenue would be sufficient to make up the deficiency. In addition, there are strong risks on the expenditure side particularly relating to debt servicing costs. The absence of any impact from the recent exchange rate pressures is not realistic particularly in view of current difficulties in financing the deficit and of the heavy refinancing requirements in the second half of the year. Failure to reach the 1994 budget targets could put the 1995 objectives out of reach.

Overall, although the tax laws go in the right direction, there is a risk that the measures in the programme are insufficient to guarantee the necessary fiscal adjustment which in turn is essential if the beneficial developments in inflation and interest rates, assumed in the programme, are to be realised. Indeed fiscal adjustment based on such an uncertain basis as revenues from the black economy could lack credibility, particularly in the absence of adequate adjustment on the expenditure side. A sounder basis for fiscal adjustment is to take the necessary revenue and expenditure measures and to regard additional revenue from the black economy as a bonus which will augment the credibility of the fiscal programme.

ANNEX

TABLE 1

Greek National Accounts for 1993

Constant price share in GDP

	1970 basis (SNA)	1988 basis (ESA)	1993 basis (ESA)
Private Consumption	74.5	74.6	74.1
Government Consumption	16.6	15.8	14.2
Gross Fixed Capital Formation	16.2	22.5	20.5
Change in Stocks	5.8	3.6	1.9
Domestic Demand	113.1	116.5	110.6
Exports Goods and Services	32.7	21.8	15.3
Imports Goods and Services	45.7	38.3	25.9
GDP at Constant Market Prices	100.0	100.0	100.0

Source: Ministry of National Economy

TABLE 2

The Revised Convergence Programme

	1994	1995	1996	1997	1998	1999
The Economy:			% change			
GDP	1.1	1.2	1.7	2.6	3.0	3.5
Domestic Demand	1.4	1.4	2.1	2.7	3.1	3.7
• **Private Consumption**	1.2	1.3	1.7	1.7	1.8	2.0
• **Gross Fixed Capital Formation**	3.4	2.7	5.1	8.0	9.4	11.2
Exports (goods and services)	3.2	3.9	4.8	5.9	6.1	6.6
Imports (goods and services)	3.6	3.5	4.9	4.9	5.3	6.0
Current Balance (%GDP)	-2.9	-2.5	-2.2	-2.0	-1.8	-1.8
Inflation (private consumption deflator)	10.8	7.9	6.1	3.9	3.5	3.3
Unemployment Rate %	10.1	10.4	10.2	9.7	8.9	7.9
General Government:			% GDP			
Current Revenue	34.7	36.7	38.1	38.3	38.4	38.5
Current Non-Interest Expenditure	31.2	30.8	30.5	30.0	29.6	29.1
Interest Payments	13.9	13.6	11.9	9.3	7.8	7.0
Government Investment	3.6	3.9	4.2	4.7	5.2	5.9
Net Borrowing (excluding privatisation)	13.2	10.7	7.6	4.2	2.4	0.9
Debt	112.1	115.2	115.3	113.4	109.3	103.4

Source: Revised convergence programme for the Greek economy 1994-1999

Table 3

Greek presentation of general government borrowing for 1993 and 1994

Drs billion

	1993	**1994**
Excessive deficit reported data	2675	2806
Convergence Programme	2587	3068
Greek forecast (ESA basis)	2586	2934
p.m. Commission forecast (SNA basis)	2751	3352

TABLE 4

Comparison of the Original Convergence Programme and the revised Convergence Programme

% change

	1993	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**
GDP							
a)	2.0	3.0	3.5	4.0	4.0	4.0	
b)	-0.2*	1.1	1.2	1.7	2.6	3.0	3.5
Inflation							
a)	12.6	7.5	6.0	4.5	4.4	4.0	
b)	13.8*	10.8	7.9	6.1	3.9	3.5	3.3
Unemployment							
a)	9.8	10.0	9.5	9.0	8.3	7.7	
b)	9.8*	10.1	10.4	10.2	9.7	8.9	7.9
Current Account (% GDP)							
a)	-2.7	-1.8	-1.4	-0.7	-0.2	+0.5	
b)	-3.6*	-2.9	-2.5	-2.2	-2.0	-1.8	-1.8
General Government Net Borrowing (% GDP)							
a)	8.6	7.1	4.6	1.8	1.1	0.6	
b)	12.5	13.2	10.7	7.6	4.2	2.4	0.9
General Government Debt (%GDP)							
a)	107.5	105.4	100.8	94.9	88.5	82.1	
b)	117.9*	112.1	115.2	115.3	113.4	109.3	103.4

a) Original Convergence Programme based on SNA national accounts and 1970 prices
b) Revised Convergence programme based on ESA national accounts and 1993 prices; the level of GDP is ±20% higher than in the 1970 based accounts.

* Commission estimates (the Commission has not yet estimated the general government deficit on the basis of the 1988 based accounts; the figure for 1993 is from the revised convergence programme)

TABLE 5

Interest Rates on Government Debt Issues January to July 1994

	Drachma Treasury Bills				Drachma Treasury Bonds (for the first year)		
Date	**3-month**	**6-month**	**12-month**	**Other**	**3 years**	**5 years**	**7 years**
Dec 31	18%	20%	20.25%	-	21.50%	22.25%	22.50%
Jan 19	-	-	20.25%	-	21.50%	22.25%	22.25%
Jan 31	17%	19%	19.75%	-	21%	21.75%	22%
Feb 14	-	-	19.50%	-	20.75%	21.50%	21.75%
Feb 28	16.50%	18%	19%	-	20.25%	21%	21.25%
Mar 15	-	-	18.75%	-	20%	20.75%	21%
Mar 31	16%	17.50%	18.50%	-	19.50%	20%	20.50%
Apr 14	-	-	18.50%	-	19.50%	20%	20.50%
May 3	16%	17.50%	18.50%	-	19.50%	20%	20.50%
May 31	25.50%	19%	18.50%	27% month	-	-	-
June 30	-	19%	-	21.50% year	-	-	-
July 15	-	19%	20.25%	-	-	-	-
Aug 1	18%	19%	20%	-	-	-	-

	Treasury Bonds linked to ECU		Treasury Bonds linked to USD	
Date	**1 year**	**3 years**	**1 year**	**3 years**
Dec 15	5.95%	6.25%	-	-
Dec 21	-	-	4.20%	5.75%
Jan 19	5.95%	6.25%	-	-
Mar 8	-	-	4.85%	6.50%
Mar 31	6.35%	7.15%	-	-
Apr 22	-	-	5.65%	7.40%
May 17	6.05%	7.50%	6.35%	7.70%
May 31	6.40%	7.85%	5.95%	7.50%
June 15	6.55%	8.05%	5.95%	7.45%
June 30	6.80%	8.30%	6.20%	7.60%
Aug 1	6.90%	8.40%	6.30%	7.80%