

After reading your response to the proposed research project on Greece in the EMU, I have a few points on your suggestions.

1. Your response seems to focus more on problems of transition to EMU in contrast to our research proposal, as originally drafted, which concentrates on problems of the steady state. As you no doubt know, both the Greek government and the main opposition party-PASOK- have already launched their own programmes of convergence with the targets laid down in the Maastricht Treaty, indicating their commitment that Greece should become a full member of EMU in 1997 or, at the latest, 1999. Solidarity behind convergence is strong enough to allow us to assume that Greece will make the adjustments and reforms needed to meet the Maastricht criteria enabling it to participate fully in EMU. However, as Greece's public debt as a percentage of GDP is one of the highest in the Community, it faces an uphill battle against budget deficits. Unless Greece radically cuts public sector deficits and puts the debt to GDP ratio on a clearly declining path at the earliest possible stage, it will not be able to meet the convergence targets set by the Maastricht Treaty. So if you feel we should focus more on problems of transition, one issue that may be worth looking at again in depth is the problem of dynamics of deficits and debt and the question of how the problem of public indebtedness can be tackled adequately in the case of Greece. The object of this part of the study will be first, to analyse the constraints the Maastricht Treaty imposes on the timetable and the content of budgetary adjustment and, secondly, to consider in some detail the specific measures that will be needed to secure the required budgetary adjustment.

2. One point worth including, which happens also to be related to the issue of debt stabilization and deficit financing, is the following. In the period of strict ERM which will precede EMU, it is expected that Greece's nominal interest rates will have to incorporate a risk premium even when its inflation rate does not diverge from the rest of the Community. This is the price that the markets will exact in order to compensate for the attenuated credibility of Greece's exchange rate commitment, resulting from its previous exchange rate history. The higher real interest rate which this implies is an unwelcome burden. Research in this area could be directed at quantifying this problem by looking at the record in other countries and at examining policy options designed to enhance credibility.

3. As to the suggestion that we could perhaps consider some institutional aspects of the transition to the third stage of EMU, such as modifications of the conditions of budget deficit financing and the preparations that must be made to ensure the independence of the central bank, I have been informed that these particular issues are already being looked at in a research project initiated by the Bank of Greece. I therefore feel there is no point in pursuing further these questions.

4. As regards your proposal that we should examine measures of structural intervention to deal with externalities such as inadequate infrastructure, poor education and training, and inefficient public administration, which currently inhibit business development in Greece, this is very acceptable as a basis on which we would like to develop research work on the broader issues (i) of the policies that would be required to improve the capacity of businesses to achieve profitable returns on investment, and (ii) the extent to which flows of investment into Greece can assist in the catching-up process and substitute for labour migration as a mechanism of response to asymmetric shocks.

5. Turning to the agenda for research included in our original project proposal, I suggest we drop (i) the proposed study on the incidence of shocks and their underlying determinants and (ii) the work on the extent to which wage and price flexibility can substitute for the exchange rate as a mechanism that might facilitate adjustment, since both issues are covered by the SPES Community programme of research undertaken by the Athens University of Economics and the University of Louvain (CORE). However, I hope that our suggestion for the investigation of the prospects of labour migration from Greece is acceptable to you, given the importance of this issue, since quite apart from the moral and social issues involved, from a purely economic perspective the possible loss of what is Greece's most valuable resource, would weaken its capacity to generate self-sustaining growth.