

GREECE AND THE EMU

When more than a quarter of a century ago, the late Premier C. Karamanlis masterminded Greece's accession to the European Economic Community, he publicly declared that Greece had entered deep waters and that henceforth it had to swim with all its available power. By any measure Greece has not become a good swimmer. For long periods it swam simply to stay afloat when all its EU partners were swimming forward. But for today's Greece swimming just to stay afloat is no longer good enough and, at any rate, it is no longer feasible.

Over the next eighteenth months Greece must not only become a competition class swimmer, it must swim in a specific direction in order to meet a very specific goal, viz. entry with the "second wave" of members into the Economic and Monetary Union. Otherwise Greece will literally miss the safety of the European boat and will have to swim in potentially stormy seas alone.

No one is more conscious of this predicament than Costas Simitis, Greece's Prime Minister. As with the case of Karamanlis, but for entirely different reasons, Simitis wants his countrymen to swim, do so fast in a specific direction and with a specific timetable. The tasks before the Simitis government have been herculean all along. But with the March decision to devalue the hitherto hard drachma by 14%, and with the bid to join the Exchange Rate Mechanism (ERM) as a prelude for joining the Euro-club by 2001, Greece must now accomplish in 18 months what it had, until recently, planned to achieve in three years. This means an aggressive

streamlining of an inefficient and bloated public sector; liberalizing the labour market and reforming the social security system in order to make employment more flexible and increase the retirement age; partial privatization of publicly held companies including state owned banks; abolition, merger or even closure of overlapping state agencies or unviable enterprises; and an expansionary public investment program (partly supported by EU funds) for major infrastructure works such as airports, bridges, extensive motorways linking Greece with the Balkan hinterland, and a complete modernization of the

country's telecommunications system. Other key areas where institutional and structural reforms must take place, include the modernization of the capital and money markets. The Athens Stock Exchange and the new Exchange established in Thessaloniki, if they are to reach their full potential as providers of investment capital, must have transparency of ownership, guarantees against insider trading,

as well as guarantees about the accuracy of financial information supplied by quoted companies. The establishment of a secondary market for government debt will also increase the international attractiveness of the bourses.

Actually during the last three years the Greek economy has been displaying steady progress in the direction of nominal but also real convergence with the rest of the EU economies. Prospects for this progress to continue do exist, provided that the government does not waver and barring unexpected or unforeseen developments. Public finances are also on the right track despite some variance between what was budgeted and what was actually spend in 1997. The



Celebrating the 2004 Athens Olympics

noticeable and significant development is that whereas from 1980 to 1993 the average rate of growth of the Greek economy was about 65% of the average rate of growth of EU countries, in the last three years it has been 50% higher than the average EU rate. Inflation has also dropped significantly and now hovers just under 5% while during the 1980 -1993 period it reached as high as 18%. Inflation is still high compared to the average EU rate and the recent devaluation will not help in the short-term. Most impressive however has been the reduction of the budget deficit which has been taking place at a much faster pace than that of the EU average. Until 1993 it stood at 13.9% of the GDP. In 1997 it fell to 4.2%, suggesting convergence to the 3% euro-criterion. As a consequence of this, the public debt first stabilized and has recently been declining. At about 120% of the GDP, it is still almost twice the EU average. These basic indicators do suggest improvement in the overall economic performance of the Greek economy. This improvement is also suggested by the declining interest rates especially on 10-year government bonds. Today their yield averages about 8.03% as compared to the German ones that today yield about 4.9%. If during the next 18 months the yield on Greek government bonds falls to about 5 - 6%, then Greek convergence with the EU would become a reality.

In light of these improvements in Greek economic fundamentals, there is optimism that after a fifteen year hiatus of continued divergence, Greece's economy is finally on a convergence course with the average EU economies. This optimism is based on the fact that those negative factors that over the last 15-20 years weighed on Greece are no longer present. These include the drop and stabilization of energy costs which have affected negatively the international economy, as well as the competitiveness and the balance of payments of Greece; the highly negative effects on the Greek economy during the transition to the new competitive EU environment due to the abolition of the high and parasitic protectionist measures of the Greek economy and the extremely high support export regime; and the unorthodox economic policies such as deficit financing and the erroneous monetary and credit policies of successive Greek governments.

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Macroeconomic imbalances are no longer created. The Greek economy today functions in an increasingly competitive environment. EU funds for major infrastructure works are absorbed at an increasing rate and investments have been increasing as evidenced by, amongst other things, the rising volume of business in the Athens Stock Exchange. Finally, Greek economic policy is now coordinated with Brussels reducing the so called "political cost" that bound the hands of successive Greek governments.

Still, the recent devaluation does indicate that the markets were signaling that the Greek economy was not competitive enough to support an expensive drachma and that without devaluation, Greece's chances to join the EMU were virtually nil. The devaluation will create short term problems

especially on the inflation and public debt fronts. But now the drachma is part of the ERM, in which participation for at least two years is a formal requirement for eventual EMU membership. Participation in the ERM increases the chances of binding the drachma to

the Euro. This points to the right direction. It suggests that the Simitis government is politically determined not to have Greece excluded from EMU. And EU partners are known to reward hard and effective work for the sake of the Union. It should perhaps not be forgotten that the EMU is primarily a political construction. It is a means to achieve greater political unity in Europe. It is also well known that the choice for the "first wave" of EMU members has been partly decided on political grounds.

What the Simitis government needs to do therefore, over the next 18 months, is to also show its determination to follow through on its promises. The government and Simitis personally, have been scoring high with Brussels until a few weeks back, when Simitis blinked in his confrontation with labour and vested interests over legislation aimed at reforming Olympic, the ailing state carrier. Reforming Olympic was a test case for wider reforms. The intense debate in parliament and the last minute backtracking by Simitis revealed an important fissure between the "new" and Euro-oriented PASOK and the "old" PASOK guard. This tension does not necessarily pose a threat to government survival. But it has revealed the significant split between the stated priorities of Simitis and old - party exigencies. In this



The Greek Banking System: Market and Supervisory Developments

The Greek banking system has undergone significant changes during the present decade brought about mainly as a result of the abolition of selective credit controls and administratively set interest rates, the complete liberalization of capital movements and the advent of the Single European Market in banking services. Banks are now essentially free to develop their activities and consequently the structure of their balance sheets and their sources of income according to their own business objectives and criteria. Competition in the banking sector has increased considerably and is likely to increase further as a result of the globalisation of financial markets, financial innovation and the impact of EMU. However, financial innovation and more intense competition have increased the range and magnitude of risks faced by Greek banks.

The Greek regulatory and supervisory framework is being significantly strengthened in order to effectively address the above issues and particularly the risks now faced by banks in a more open, competitive and financially sophisticated domestic environment. The transposition into national legislation and the implementation in Greece of all EU banking directives has been the most important component of the change in the regulatory framework. Banking supervision is now placing primary emphasis on the avoidance and containment of systemic risk and is being supplemented by a comprehensive deposit - guarantee system established in 1995.

Bank supervision is carried out by the Bank of Greece both by means of onsite inspections and by means of monitoring of the prudential returns submitted by banks and focuses in addition to capital adequacy, liquidity, earnings and concentration of risks on the evaluation of the adequacy of the banks' administrative organization and their systems of internal controls.

As regards the trends and prospects of the greek banking sector, important developments are taking place. After the establishment of six new private banks in the early 1990's the number of banks has stabilized, with the exception of co-operative banks which are growing in number but their total market share is likely to remain very small and their activities locally concentrated. A consolidation process is under way in the banking sector and is likely to gain momentum in the future under the pressure of increased competition and the need to achieve economies of scope and scale. Banks directly or indirectly controlled by the state continue to dominate the sector, but there are con-

crete plans to privatize some of the smaller state-controlled banks in the near future. Both private and state-controlled banks, have expanded domestically into other areas of the greek financial sector mainly by establishing specialist subsidiaries and also internationally through branches and banking subsidiaries. Expansion abroad has been directed towards the European Union area and towards the Balkans and the Black Sea area. In the case of the Balkans and the Black Sea area, expansion of Greek banks has been motivated both by the need to service the business activities of their customers and to establish a presence in the early stages of the development of these new financial markets in order to exploit profitable opportunities and is in line with the greek government's policy to promote closer economic ties with these countries. From a supervisory perspective, although the long - run effects of this expansion abroad on the growth and profitability of the banks are expected to be positive, there are short -to-medium term risks which must be closely monitored and controlled.

As a result of liberalization and despecialization, increased competition and the other trends previously mentioned, there have been changes in the structure of the balance sheet and the sources of income of many greek banks. The proportions of consumer and of residential loans to total loans have significantly increased as also is the case with respect to the proportion of loans denominated in foreign currency. The expansion of bank activity in other financial services beyond deposit-taking and lending has contributed to a greater diversification of their sources of income and to a very significant increase in the total value of their off-balance sheet items, mainly relating to derivatives and to custody and funds management services. From the supervisory viewpoint, this implies greater vigilance in the areas of interest-rate and exchange-rate risk and more attention to the adequacy of the banks' risk management systems even though credit risk, including that originating from derivatives activities, continues to play a dominant role. Banks are responding to these changes by upgrading their risk measurement systems and related internal controls. The Bank of Greece, for its part, intends to monitor developments closely and exercise pressure for further improvements in such systems where necessary.

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OTE: A connection of Importance

Telecommunications underpin the contemporary world, while information has always formed the basis of any civilization. Information is communicated at variable paces. Its speed depends on the quality of the means that carry it, be they conventional telephones or high-tech electronic highways.

The Hellenic Telecommunication Organization, OTE, makes information available to Greece and through Greece to the world. OTE is the largest telecommunications organization in the Balkan region and one of the fastest growing telecommunications enterprises in Europe. Its 1997 earnings exceeded 311 billion drachmas (one billion USD). No less than 22,000 people are employed by OTE. They partake in decisions the aim of which is to constantly upgrade the system in order to serve every and all customers. Beyond conventional communications OTE offers forty other services aimed at meeting the needs of every demanding user. These services range from video and teleconferencing to modern cellular communications.

Modern data transmission systems are crucial since they enable us to create additional services that make modern life more comfortable. ATM machines, credit card transactions, electronic transfers of funds and data, are all made possible through these systems. In Greece, OTE currently provides 55 telephones for every 100 customers. This represents the highest telephone density in Europe. More than five million customers are served by OTE.

The Hellenic Telecommunication Organization owns two high-tech earth satellite stations. OTE is also shareholder in INTELSAT, EUTELSAT and INMARSAT and is actively involved in the construction of the new worldwide telecommunications environment. OTE is also active in the modernization and development of the communications systems of various Balkan and Black Sea countries.



Mr. Georgios Chryssolouris, Managing Director Of Hellenic Telecommunication Organization

21ST CENTURY OTE

Through an ambitious but realistic program, OTE will keep pace with the fast moving environment of the information age by:

- *maintaining its dominant position in the Greek market and also selectively entering overseas markets, especially in the Balkans*
- *expanding and increasing its operations with investments that will exceed one trillion drachmas (three billion US dollars) by the year 2000*
- *offering digital services and upgrading the quality of conventional telephone communications*
- *taking full advantage of and offering its customers all available services*
- *making available digital television and multimedia*
- *forming international alliances*
- *establishing itself as the premier telecommunications hub in the Eastern Mediterranean and the wider Balkan region*
- *making available advanced technology for the every day use of people*

OTE IS A VERY IMPORTANT CONNECTION

Hellenic Telecommunication Organization: 99, Kifissias Ave. GR-151 25, Athens, Greece

regard, Simitis may yet spring a surprise and go to the polls early in order to renew his mandate for the necessary reforms. He is known to have successfully done this in the past when he felt that his authority was challenged or when he came up short, as with the case of Olympic Airways.

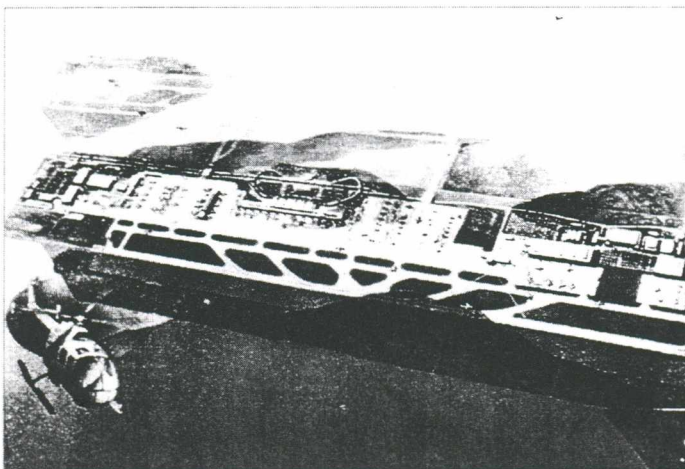
Meanwhile and partly to also make up for the Olympic setback, the Simitis government announced, in a surprise move just before Greek Easter, the biggest bank merger in Greek history. The National Bank of Greece, the country's largest, will merge with another state-owned bank, Mortgage Bank, to form the largest bank conglomerate in Greece with over 12,5 trillion drachmas (39 billion USD) in assets. The merger is expected to have a chain reaction within the Greek banking system. It will hasten the already taken decision to sell other state-owned banks and will force private banks to take quick action to protect their interests in a more competitive environment. The merger is also aimed at increasing Greece's international financial competitiveness and at countering competition, especially from EU banking concerns that view Greece as the only "emerging market" within the EU.

This positive view of Greece on the part of foreign banks, other financial concerns, and institutional investors is certainly reflected in the Athens and Thessaloniki Stock Exchanges, especially the former, which since the drachma devaluation has been enjoying unprecedented activity and growth. It is true that speculation is part of the spectacular rise of the Athens bourse. But it is also reflects the confidence of foreign and domestic investors that the future looks positive for Greece. The Simitis government, at any rate, faces a Hobson's choice. It must succeed.

Meanwhile, the National Economy Minister is finalizing plans for a third package of Hellenic Telecommunications Organization (OTE) shares to be sold for about 480 billion drachmas (1.5 billion USD). Another 80 billion drachmas (250 million USD) are expected from the sale of 20% of the shares of the Public Petroleum Corporation (DEP) expected to take place by early summer. The sale of

state-owned banks will also enrich the public treasury as will the successful conclusion of the search, now underway, for a strategic investor for Olympic Airways.

Under the direction of the Minister of National Economy, a National Action Plan is also been implemented. A National Coordinating Committee for the Euro has been formed. Membership consists of the presidents of virtually all major Greek society institutions. Their task is to draft a national strategy for the transition from the drachma to the Euro with a minimum of problems and to supervise and coordinate existing committees or ones scheduled to be formed. The Committee is also charged with articulating Greece's position and concerns, primarily to the EU and other international organizations.



Eleftherios Venizelos Airport: A 21st century hub

Not unexpectedly, the private sector, especially the banking and business community, has been ahead of the government in many regards.

The Federation of Greek Banks, for example, has been in constant contact with the Banking Federation of the European Union and is currently establishing a training and seminar center for its employees. The Federation of the Greek Industries has been labouring along the same path.

Greece's entry into the EMU depends on many factors. For its part Greece must dispel any and all suspicions and show that it is willing to pay the euro-criteria price and that it is ultimately fit for EMU membership despite of its deeper structural problems. Still the Greek government will ultimately be judged on account of its efforts and its self-imposed discipline. The final decision will be largely political. It will also depend on factors beyond Greece's control. These include the performance of the Euro-economies of countries such as Germany and France and also how the Euro fares against the "other" single currency area, that of the dollar.

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