A EUROMONEY CONFERENCE

GREECE IN THE WORLD ECONOMIC COMMUNITY

HOTEL ATHENAEUM INTERCONTINENTAL · ATHENS

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Transcripts

A EUROMONEY CONFERENCE

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HOTEL ATHENAEUM INTERCONTINENTAL · ATHENS

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CONTENTS

DAY ONE - 20 APRIL 1988 Page

CHAIRMAN'S ADDRESS: A WORLD ECONOMIC OUTLOOK 1

Minos Zombanakis

EUROPEAN INTEGRATION: THE NEXT FOUR YEARS 6

Lord Plumb
President
European Parliament

EXPERIENCES OF A NEW EC MEMBER COUNTRY:
RECENT DEVELOPMENTS IN THE PORTUGUESE FINANCIAL SYSTEM 12

Tavares Moreira
Governor
Bank of Portugal

THE EUROPEAN COMMUNITY: DISMANTLING INTERNAL BARRIERS
- THE EFFECTS ON INDIVIDUAL ECONOMIES 19

Loukas Tsoukalis
Oxford University/College of Europe

THE INTEGRATED MEDITERRANEAN PROGRAMME
- THE PROMISE OF A NEW DEAL 28

Jerome Vignon
Director
Advisory Group to the President
European Commission

FOREIGN INVESTMENT AND CAPITAL FLOWS:
AN INTERNATIONAL PERSPECTIVE 32

Nicholas Nanopoulos
Senior Manager, Investment Department
The World Bank

CONTENTS

DAY ONE - 20 APRIL 1988 continued — Page

JAPANESE DIRECT INVESTMENT TO GREECE
- PRESENT SITUATION AND FUTURE PROSPECTS — 55

Minoru Tsuyuki
Director
The Bank of Tokyo Ltd

KEYNOTE ADDRESS — 62

Andreas Papandreou
Prime Minister

DAY TWO - 21 APRIL 1988

AN OVERVIEW OF THE GREEK ECONOMY — 73

Theodoros B Karatzas
Deputy Minister for National Economy

THE GREEK FINANCIAL SYSTEM - THE ROAD TO DEREGULATION — 88

Dimitrios Chalikias
Governor
Bank of Greece

GROWTH POTENTIAL, CAPITAL MOVEMENTS AND
THE GREEK FINANCIAL MARKETS — 99

Andreas Ch Boumis
Chairman
Commercial Bank of Greece

CONTENTS

DAY TWO - 21 APRIL 1988 continued — Page

THE SPANISH ECONOMY TWO YEARS AFTER ITS ENTRY INTO THE EUROPEAN COMMUNITY — 107

Federico Prades
Director General
Ministerio de Economia y Hacienda

PANEL DISCUSSION:
COMPETITIVENESS AND THE EUROPEAN LABOUR MARKET

John Morley (Chairman) — 123
Head of Division
European Economic Commission

Theocharis Papamargaris — 126
President
Greek Federation of Bank Employee Unions

Nicolas Analytis — 128
Member of the Board of the Federation of Greek Industries in charge of Social and Labour Affairs

INSTITUTIONAL INVESTMENT IN GREECE AND OTHER MEDITERRANEAN COUNTRIES: AN OVERVIEW — 139

William Richards
Executive Director
Sun Life Investment Management

EVOLUTION IN WORLD BANKING — 148

Hans H Angermueller
Vice Chairman
Citicorp/Citibank

CHAIRMAN'S ADDRESS: A WORLD ECONOMIC OUTLOOK

Minos Zombanakis

CHAIRMAN'S ADDRESS: A WORLD ECONOMIC OUTLOOK

Minos Zombanakis

I should like to give a brief review of the world economy as we see it today.

The Interim Committee of the IMF met recently in Washington to review the world economic outlook. It observed that the industrialised countries grew at a substantially stronger pace in the latter part of 1987 than was originally anticipated but the outlook for growth in 1988 was somewhat more pessimistic. Moreover, projections for growth in the developing countries were poor at best. Although the world economy was continuing to expand at a moderate rate of about 3% per annum, the persistence of large fiscal and external imbalances continued to cloud the international economic outlook.

Payments imbalances among the major industrialised countries are expected to continue over the medium term at an unsustainable rate if the appropriate policies of adjustment are not adopted. In the meantime, the markets remain concerned about the size of the US fiscal deficit and the continuing, large external imbalances of that country. One has to see the stock market plunge in October 1987 as a partial manifestation of these concerns. The same holds true for the unsustainable conditions in the foreign exchange markets.

Rates of economic growth of many developing countries have remained low or even declined and investment has not revived. Efforts to adjust their economies could not produce the desired results and this is indicated by the acceleration of inflation and the increase in fiscal deficits.

Starting with the industrialised countries, let me be more specific. In the United States, one should expect that growth in output will be maintained at about 2.5% in 1988 as compared with 2.9% in 1987. In an election year, no-one should expect the authorities to do anything that might curtail consumption, even though this is probably exactly what they should be doing now if for no other reason than to curtail imports and boost exports.

Japan's performance is expected to remain strong. The rapid expansion in domestic demand will continue and this will compensate for any loss of exports due to a revaluation of the yen. Total output may reach as high as 4% in fiscal year 1988-1989.

In the United Kingdom the large expansion in domestic demand will continue, fuelled by an increase in disposable income following the tax cuts of the recent Budget, by the strong credit expansion and by the fiscal stimulus that has been created through receipts from the government's privatisation programme. However, because of the strong expansion in domestic demand and the rise in sterling, a deterioration in the balance of payments will occur and this will cut output to about 2.5% in 1988 in comparison with 4% in 1987.

In Germany growth is expected to remain below 2% for the next year or two, mainly as a result of the revaluation of the Deutschemark and the decline in domestic demand. The Germans are happy with this level of growth although, as we know, many others are not.

In France it is estimated that growth in output will be weak as a result of continued problems with the balance of payments and further decline in fiscal stimulus due to fears of price inflation.

In most of the other industrialised countries the growth in output is expected to slow down or remain modest, with the notable exception of Spain, which is expected to continue to enjoy a relatively strong growth rate.

As to the developing countries, the aggregate rate of growth should reach about 4% in 1988/1989, an improvement over the previous year, nevertheless well below the rates they enjoyed in the 1970s. The only group of developing countries that will maintain strong growth is the newly industrialised economies of Asia, the 'Tiger' countries. At the other end of the spectrum, however, output in sub-Saharan Africa was lower again this year than the rate of growth in population and no significant improvement is expected.

The oil-producing countries have been negatively affected by the weakness in oil prices since 1986 and by a significant depreciation of the dollar, since the price of oil is quoted and paid in dollars. This loss of income has caused an enormous deterioration in their terms of trade over the past three years and the subsequent decline in their total output. Not much improvement should be expected here as oil prices are not about to rebound in any serious way in the short or medium term.

It would be a neglect on my part if I did not say a few words about the Communist countries. After many years of stagnation in output, most of these countries are in the process of restructuring their economies with the aim of removing obstacles to investment and increasing output. Some - China, for example - have already met with some success. Others are struggling to overcome the stringencies that exist in their system but I hope that, in the end, they will succeed in their objectives for this would be very positive for them and very good for the rest of the world.

The foregoing more or less represents the consensus about what will happen in the near term, short of any turn-around of events - nothing exciting, on the other hand nothing catastrophic.

I should now like to say something about a development which could cloud the scenario. I shall start with the subject of trade and external imbalances which I think constitutes the greatest danger to the world economy.

The volume of trade expanded by 4.5% in 1987 and a similar rate of growth is expected in 1988/1989. Demand for imports in Japan has accelerated as the Japanese government, responding to international pressures and local demand, has adopted policies of domestic reflation. To a lesser extent, demand for imports has also increased among the countries of Europe and the Asian newly-industrialised countries. This by itself should have contributed to an improvement in the external position of the United States and worked towards the lessening of world imbalances but unfortunately the trade deficit of that country continues to be large. Though exports have increased by 20% in volume terms in the past year, demand for imports persists as the United States economy maintains a level of consumption that goes far beyond the ability of local capacity to satisfy. As a result, and in spite of the depreciation in the dollar, the trade deficit of the United States increased by a further 20% in 1987, to reach over $160bn.

On the other side of the scale, Germany's surplus reached $44bn while the Japanese surplus remained stable at a level of about $85bn. More significantly, the United States current account deficit amounted to 3.2% of its gross national product in 1987 while the surpluses of both Japan and Germany expanded to 4.25% of their respective GNPs.

No doubt improvements will be recorded as efforts to co-ordinate policies among the major industrialised countries and the depreciation of the US currency have their effects but the fact remains that no-one is willing to make a prediction as to when these imbalances will disappear.

Thus the main danger to the world economy today emanates from the precarious position of the United States economy. In 1986, that country turned from a traditional position of net international creditor to a net international debtor for an amount equivalent to about 6.5% of its GNP. In the same year, Japan and Germany were creditors for amounts equivalent to 8.5% and 10.5% of their respective GNPs. Under present conditions, these external positions will continue to widen and by 1992 may reach net debtor and creditor positions of over 20% of GNP.

This prospect is very dangerous, for a variety of reasons. First of all, the United States will be faced with the problem of servicing an ever-increasing accumulation of external debt which in terms of interest payments alone could amount to well over $100bn per annum for many years to come. On top of that, it will have to borrow to cover its annual trade deficit. It is difficult to see how this can be achieved without an effect on net savings, interest rates and levels of growth in that country.

As the external debt of the United States increases in years to come, the consequences of adjustment could be serious for the rest of the world. Considering the size of the United States economy, any attempt to eliminate the trade deficit and, in addition, to create the surplus necessary to repay accumulated debt could bring unsustainable pressure to bear on the rest of the world. Simply speaking, we may be faced with a worldwide recession when that process starts.

On the other hand, the surpluses of Japan and Germany have to be accommodated within a monetary system in which the key currency of reserve asset accumulation belongs to a debtor country. The practical question must inevitably be asked, at what price will the Japanese and Germans be willing to deposit or lend their money to the United States, knowing that its capacity to repay at predictable exchange rates will be constantly eroded by the deterioration in its balance of payments position?

There is no answer, of course, to this question, for many things must be taken into consideration, including political and strategic factors. Nevertheless, the threat remains and, unless a way is found to fund the accumulated debt of the United States in good time and the right policies are adopted by all the major industrialised countries to help eliminate the increasing imbalances, the United States may be forced to resort to protectionism, to engineer a recession or to do both.

In the meantime, the surplus countries may try to divert their trade to other zones of economic interest, with unforeseen consequences on the present pattern of world trade and its development. Germany for example can concentrate more on its trade with the Common Market. This could upset many Europeans and would not be too good for the rest of the world. As for Japan, I don't propose to guess what they may do when they are faced with protectionism.

Thus the new President who will emerge from the forthcoming elections in the United States will have to address himself to the root of the problem that creates these world imbalances, ie the rate of savings accumulation. According to the OECD, United States household savings as a percentage of household income was about 4.5% in 1986. Since then it has deteriorated. In comparison, the German rate was 12% and the Japanese rate 17%.

In a recent article on Reagonomics that appeared in Atlantic Monthly, a former member of the Republican administration stated:

> "Behind the pleasurable observation that real United States consumption per worker has risen by $3,100 over the current decade lies the unpleasant reality that only $950 of that extra annual consumption has been paid for by growth and by what each of us produces. The other $2,150 has been funded by cuts in domestic investment and by a widening river of foreign debt."

This, in a nutshell, is the problem and there is no way to change it unless the United States increases its rate of savings in order to invest in new and efficient capacity, allowing the country to contribute towards a restoration of world trade equilibrium. In a world of rapid technological evolution, a high rate of savings becomes even more imperative, for you need excessive amounts to write off obsolescence and to remain efficient and competitive. In short, the United States badly needs a policy of industrial revival.

I do not suggest that this is easy. The American people will have to undergo years of a reduction in their rate of consumption and this is hard, both politically and sociologically, to contemplate, but I see no other way out of the present impasse. You cannot consume your total production without making provisions for investment and still expect progress.

Let me now say a few words on the other problem that may cloud the relative optimism of the world economy - the LDC debts. The total outstanding debt of the LDCs has reached an amount of $1,200bn. Most of this is centred on the 15 relatively large countries, especially those in Latin America.

The ministers of the Group of Seven industrialised nations restated recently their opposition to any schemes of forgiveness. I assume that they did this not only out of moral conviction that you should repay what you borrow but also out of a practical consideration which centred on the inability of the world banking system to absorb a loss of such magnitude and still to survive.

However, while they oppose forgiveness, they are behind various schemes that call for a relief of the debt burden. I do not intend to outline the schemes here but they all recognise that some debt has to be written down, initially as write-offs from the profits of banks and subsequently as tax-deductible items. The taxpayers of the large industrialised countries will in some way or other have to pay for a large part of the final bill.

In terms of magnitude, the debt problem of the LDCs has, if anything, deteriorated. What is important, however, is that both debtors and creditors have become accustomed to live with each other in an environment of hope and mutual accommodation. What is needed now is time to effect this gradual absorption through the various schemes and to allow for these economies to regain their impetus to growth.

All these adjustments can take place if the world economic environment remains positive and it is for this reason that I have to conclude my remarks by saying that the key to the future is the behaviour of the countries of the seven large industrialised nations and, above all, the management of the United States economy under the administration that will emerge in 1989. The world cannot secure uninterrupted growth and avoid the consequences of a collapse in production and trade if the largest economy of the world cannot cure itself from its structural illness. America has been the pillar of world economic growth for almost half a century and I hope it will find a way to continue to play that role.

EUROPEAN INTEGRATION: THE NEXT FOUR YEARS

Lord Plumb
President
European Parliament

EUROPEAN INTEGRATION AND THE CREATION OF A SINGLE MARKET BY 1992

Introduction.

For those of us in the European Parliament, the last few years have been characterised by many dramatic and important developments.

None more so than the question of achieving the single European market by 1992.

But it is very important to look back in order that we may better look forward. I say this very deliberately because there is a belief in many parts of Europe that the single market idea is a new idea, that it is some new proposal designed by Lord Cockfield to embarrass the Member State governments.

It is of course nothing of the sort. It is in the Treaty of Rome, signed over thirty years ago by the original six Member States, and by the others at the time of their subsequent accessions.

In the early years of the European Community, much of the effort in regard to achieving a common market was directed towards implementing the Customs Union and establishing the Common Customs Tariff. This is now in operation, with Spain and Portugal due to complete their processes by 1992. The Customs Union was achieved between the six founding members just under twenty years ago in July 1968.

The establishment and administration of the Common Customs Tariff made a decisive and lasting contribution to the international recognition of the European Community in world affairs.

But anyone could be forgiven for wondering what it all means as far as the European Community itself is concerned. There are still customs controls throughout the Community; there are still petty allowances and restrictions of many types on the movement of goods and services in Europe.

In 1985 the European Commission drew up a detailed programme for the creation of a single common market by 1992 in its White Paper 'Completing the Internal Market'. This White Paper contains over 300 separate proposals, each with a target date for agreement. The proposals concern the abolition of barriers of all types, the harmonization of laws, tax structures, commercial regulations, standards and procedures.

The European Parliament has always been close to the centre of this action. For years we have been saying that the creation of a genuine common market is essential for European economic recovery. All European countries have, in the past few years, been engaged in a national debate about the competitiveness of their industry, particularly in the manufacturing sector. And all this debate has remained at a national level, while we were even then being overtaken by the Japanese in industrial competitivity and in the race for the penetration of newer export markets.

In some countries, the proposal to be serious about creating a genuine common market in Europe has been received with hostility. We in the Parliament can understand this up to a point, but we have often stressed that there is no question of trying to place all national laws under Community control. There is certainly no question of increasing the amount of red tape. We are looking for decontrol. We are looking for measures to liberalize trade, not to continue to clog it up with restrictions.

So the customs union is not yet complete, mostly because of insufficient harmonization of customs procedures and all those technical, administrative and fiscal barriers to trade.

This year has seen an important advance: the introduction of the 'single administrative document'. This replaces no less than 70 different forms. I know that there have been some difficulties in its introduction, but I believe these to be teething problems only. In addition, many of the customs procedures have now been computerized according to the coordinated development project, part of the CADDIA programme.

The creation of a genuine common market continues to be impeded by legislative differences, national safety standards, public health regulations and fiscal problems. It is worth remembering that the practice nearly measures up to the theory. Since the Cassis de Dijon judgment in 1978, producers can take legal action if a product legally produced and marketed in one Member State is denied free access to the market of another Member State.

But there remain many areas in which very little progress has yet been made. Financial services spring to mind: mortgages, insurance and the securities market remain bound by national jealousies. Some Directives adopted by the European Community in the early 1960s created freedom of movement for certain types of capital, but since then no progress has been made. I welcome the recent Commission proposal in respect of banking in Europe, and I hope that the Member State governments will give a high priority to it in the Council of Ministers.

In the transport sector, we have not only a lack of action but also a recognisably guilty party. In its judgment of May 1985, the Court of Justice ruled that the Council had infringed the Treaty by failing to ensure freedom to provide services in international transport and to lay down the conditions under which non-resident carriers might operate transport services within a Member State. Three years later very little has happened.

The recent much-vaunted agreement on air fares does take us a step forward. But in my personal opinion, it should encourage us to demand yet more liberalisation of this highly protected sector. We should take this agreement as a beginning, not as an end.

I hope that we do have a genuine common market by 1992, but things will have to move a lot faster than they are now if this goal is to be achieved. We need the help of the public, and our job henceforth must be to harness public opinion in all the Member States to the task ahead. Inevitably, this public debate will also cover questions related to European political integration.

I am confident about the future. I am confident because I am a born optimist. I have to be. So while I know that there is a lot of work to be done between now and 1992 if we are to stay on course, I also feel that we are entering a new, productive and creative period in Community decision-making. We are, I believe, about to enter a phase in Community politics in which the governments can better appreciate the merits of further European cooperation and integration.

As a single unified market, Europe would at last take its rightful place in the world order. The implications are enormous, but let us always remember that the United States of America took at least one hundred years in its creation, and there are many around who do not believe they have managed it yet. Here we are, little more than thirty years after the signing of the Treaty of Rome, and just over forty years after the world war. Some of us are impatient already for a united Europe.

I want to investigate with you what it is that makes unity. Do we need a unity demonstrated by an identity of culture? No, I do not think so. We do not need a harmonised Euro-culture. Europe is so rich in its cultural diversity that I, particularly as a true-born Englishman, and a Warwickshire man to boot, recognize and respect very strongly the appearance, existence, the flourishing of regional and racial cultures of and within our countries.

Do we need a unity based on the approximation of our economies? A unity generated by the need for the more developed countries of Europe to contribute substantially to the development of the poorer regions, especially the Mediterranean areas? Now that is more to the point. This duty is set out in the cohesion articles of the Single European Act and given substance by the conclusions of the European Council that expenditure on the Structural Funds should be doubled by 1993.

The attraction of the internal market is that it offers economic benefit to the Community as a whole, and is perhaps our best hope of sustaining economic growth throughout the whole of the Community, North and South. Indeed, there are parts of Europe whose competitive advantage will permit them to gain from a total freedom of trade in the European market. The single market is not just a prize for the entrepreneur and the capitalist. It is for everyone.

The European Community will continue, however, to be only a very partial achievement unless we can engender better economic integration within its boundary. A united Europe, operating a genuine common market, would have a far greater meaning to all our citizens for this reason alone.

In the end, what makes real unity is people. People, not taxes. People, not vague policies. People, not even laws. Europe is a Peoples' Europe or it is nothing. If I stopped believing that then I would stand down immediately as the President of the European Parliament.

So this unity, which I hope will be achieved by people acting together, freely and willingly, in other words - in the spirit of integration - is the real implication of a genuine common market.

I do not believe that the European Community will achieve its objectives only by intergovernmental agreements, unless these result from a manifestation of public pressure on the Member State governments.

Europe will be so much stronger with this combination. A free and voluntary movement of people, goods, services and capital across our borders.

Ladies and Gentlemen. I have the honour of belonging to both the oldest and the youngest Parliament in Europe. The European Parliament may be an infant, but it is a prodigious infant. I know that its role in the process of building Europe is vital, and I am proud to be able to assist in this process; the process of creating a single market and also of creating an integrated Europe for all our people.

EXPERIENCES OF A NEW EC MEMBER COUNTRY:
RECENT DEVELOPMENTS IN THE PORTUGUESE FINANCIAL SYSTEM

Tavares Moreira
Governor
Bank of Portugal

EXPERIENCES OF A NEW EC MEMBER COUNTRY:
RECENT DEVELOPMENTS IN THE PORTUGUESE FINANCIAL SYSTEM

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Portugal acceded to the EC on 1 January 1986, at a time when the Portuguese economy was coming out of a difficult period of adjustment which it underwent along with a severe stabilisation programme.

The Portuguese economy proved to be highly adjustable, particularly as regards the recovery of an external equilibrium, just as had happened with a former stabilisation programme implemented in 1978. To illustrate this phenomenon I should point out that, after current account deficits from 1981 to 1984 which ranged between 3.3% (1984) and 13.5% (1982) of GDP, the current account shifted into a surplus of 1.9% of GDP in 1985 which rose to 4% in 1986. On the other hand, the external debt, which had reached 78% of GDP by end-1985, fell to nearly 55% in 1986 (and is estimated to be 45% in 1987). This reduction in the external debt was possible due to a current account surplus and the significant capital inflows recorded for the past two years.

At the same time there was sharp disinflation. The inflation rate, measured by the Consumer Price Index, fell from 30% in 1984 to 19.3% in 1985 and 11.7% in 1986 (annual average figures).

It may thus be stated that EC accession took place at a crucial point in time of the Portuguese economy, which admittedly facilitated the first stage of adjustment to the Community rules, particularly regarding measures for the liberalisation of foreign trade, and capital movements.

Furthermore it should be noted that EC accession proper had a large impact on the performance of the Portuguese economy, by allowing wider business prospects and favouring initiatives in various sectors.

Today it is clear there is an "EC effect" on the Portuguese economy in the following fields:

- Growth and structure of foreign trade
- Economic growth rate, particularly the expansion of investment
- Unrequited transfers and capital inflows
- Modernisation of the financial system, mainly in the areas of foreign exchange and capital markets.

Foreign trade recorded a significant acceleration in 1986 and 1987. Exports grew by 9% and 11% in 1986 and 1987 (in real terms) while imports rose even faster, by 18.5% and 23.5% respectively.

With regard to the geographical distribution of foreign trade, developments were as follows:

	As a Percentage of Total	
	Imports from EC	Exports to EC
1984*	43.0	61.8
1985*	46.0	62.4
1986	58.8	68.0
1987	63.4	70.9

* including Spain

The evolution of external trade with Spain was remarkable, as it rose from fifth position as an exporter to Portugal and sixth position as an importer from Portugal in 1985 to second exporter and fourth importer in 1987, showing a tendency to gain an even higher-ranking position.

Despite the negative contribution of the external sector resulting from the strong increase in import volume, the pace of economic growth has accelerated in the past two years. After negative growth in 1983 and 1984 and 3.3% growth in 1985, the growth rate of GDP stood at 4.3% in 1986 and 4.7% in 1987.

The growth rate of investment was close to 20% in real terms in 1987 versus 9.5% in 1986 and (negative)-3% in 1985.

Unrequited transfers and the performance of non-debt capital movements have also been outstanding. After a period of stagnation in the early 1980s and some decrease in 1984, unrequited transfers rose sharply in 1986 (30% in US dollars) and in 1987 (27% in US dollars). In 1987 they reached over US$3.3bn. Part of these increases in private transfers correspond to actual capital inflows derived from the accumulation of overseas savings during past years.

There was also a revival in capital movements. After successive years in which non-debt capital inflows were practically confined to negligible foreign direct investment (US$160m on average in 1983/85) and non-controlled capital outflows reached a large amount, we have witnessed a reversal of this in the past two years. Indeed, we have seen strong capital inflows, aside from foreign direct investment. In 1987, following the liberalisation of foreign investment in listed securities on domestic stock exchanges, net capital inflows to the stock market have been of the order of US$600m to US$700m.

Widespread changes have been witnessed in the financial system and market performance since EC accession. To be more precise, it should be stated that this process began two years prior to the date of accession. There is no doubt that in this changing process lay the prospect of the implications of accession to the EC. Indeed, in February 1984, the banking system, which had been closed by force of law, was opened to private capital. Since then 11 new private banks have been incorporated, six of which are foreign-owned.

Simultaneously, a number of non-monetary financial companies were created, namely:

- Investment companies, which were given a legal status similar to that of merchant banks (but not authorised to take deposits). These companies have played a very active role in the revival of the capital markets (there are eight in operation at present).

- Leasing companies, both for equipment goods and real estate. A large expansion in their turnover has taken place in the past two years. (Seven companies operate in equipment assets and one in real estate.)

- Factoring companies, which have also been very buoyant (four in operation).

- Venture capital companies, created as of 1987 (two in operation) with extremely favourable tax status.

- Investment funds, whose operational status is similar to that of unit trusts, for investments in securities or real estate (six funds in operation for securities and four funds for investment in real estate). They are expected to multiply rapidly throughout the current year.

- Finally, pension funds, created in 1987 and expanding very rapidly (67 pension funds are already constituted).

This growth of new institutions in the financial sector occurred while there was strong expansion of the equity and bond markets, as illustrated in the following tables:

PRIMARY MARKET*

PUBLIC ISSUES	100C	100C	1007
Shares	-	29.000	64.700
Corporate bonds	45.000	29.000	88.600
Treasury bonds**	57.000	78.000	127.000
	102.000	136.000	260.300

* In million escudos

** Only medium- and long-term bonds placed with the public (does not include Treasury Bills)

SECONDARY MARKET

INDICATORS	1985	1986	1987
- Number of listed companies	50	81	176
- Number of listed Bond Issues	162	219	224
- Market capitalisation*			
- (Shares)	33 600	267 500	1 182 857
- Trading volume			
- Shares			
- Number	997 938	4 757 926	22 948 230
- Value *	851	11 072	197 487
- Bonds			
Number	11 740 006	10 674 016	25 700 287
- Value*	11 646	31 750	62 670

* In million escudos

It can be concluded that this strong growth came about as a combination of several factors:

- Renewed confidence of economic agents, both financial investors and companies, in part due to the "EC effect"
- In 1986, the implementation of tax incentives allowing individuals to invest in the security markets, including investment in initial public offerings
- Liberalisation, since February 1987, of foreign investment in the Portuguese stock market.

In line with this performance in the capital markets, there were also significant changes in the financing of the public sector deficit.

Up to 1984, most of the public sector deficit was financed through the banking sector, namely the central bank. However, this began to change in 1985 when the share of non-bank financing rose to 37% of the public sector borrowing requirements (PSBR).

Non-bank financing became more meaningful in 1986, accounting for nearly 70% of total PSBR. In 1987 non-bank financing fell to 46% of PSBR. It should be mentioned that the central bank did not finance the public sector at all in 1987, rather the bank financing required was obtained from other banks at market rates.

This new public-sector financing policy, which was set with the aid of the central bank, is largely responsible for the increase in budget interest charges and the growth of public debt. It is worth mentioning that the 1988 budget deficit equals the amount of public debt interest (approximately 470bn escudos) ie nearly 8.5% of GDP. On the other hand, interest payments account for 35.5% of total budget revenue and for 26.5% of overall expenditure whereas total public debt nearly tripled between end-1983 and end-1987, accounting for approximately 75% of GDP.

The introduction of Treasury bills (TB) in August 1985 was largely responsible for this change in the financing of the public sector. TBs are short-term (up to one year) public debt securities issued by the central bank through auctions and have been widely accepted by the non-bank public (firms and individuals) on the secondary market. At the present time, TBs account for nearly 20% of total public debt.

Despite its drawbacks this new public sector financing policy constitutes a fundamental requirement for the modernisation of monetary policy. Indeed, we are planning before year's end to change it into a system of indirect monetary control of central bank intervention in the monetary base through open-market operations. The prevailing ceilings on domestic bank credit (accompanied by control over external credit) will be replaced.

Along these lines, progress was also made with regard to the deregulation and increased flexibility of the markets' operations, with special reference to money and foreign exchange markets.

As for the money markets, steps have been taken towards the liberalisation of bank interest rates. Up to mid-1984 every bank's interest rate was administratively fixed. There were 12 different interest rate limits, for deposits and loans. Now there are only two rates:

- a single maximum rate for bank loans (at present standing at 18%), regardless of the term; and

- a lower interest rate for bank deposits with maturities greater than 181 days (rates on deposits at shorter terms are freely negotiable between banks and their customers), excluding certificates of deposit which rates are freely negotiable.

It is envisaged that, among the various measures that will be taking place to change monetary control, the setting of a maximum interest rate on bank loans will soon be discontinued.

According to the commitment undertaken in the Accession Treaty, viz to adjust the operation of the market to the conditions prevailing in the markets of other EC countries, the foreign exchange market has gradually been deregulated. Thus in October 1985 a spot market began to operate where banks could carry out foreign exchange operations among themselves, with overseas banks and their clients, thereby freely negotiating the applicable exchange rate. The Bank of Portugal established guidelines for each bank within which it could trade.

Rules for the operation of the forward exchange market were defined as of 1987. The initial maximum period was six months, later lengthened to one year, and available for both current and capital operations.

In October 1987, the exchange rate began to be market-determined through a fixing system with the participation of banks and other institutions authorised to deal in foreign exchange. The Bank of Portugal intervenes in this market, either buying or selling, whenever necessary to guide the exchange rate towards the target fixed according to the exchange rate policy.

Now banks are allocated an overall ceiling position and may show long or short, spot or forward positions. Our main purpose is to carry out a complete restructuring of the existing foreign exchange regulations in force, in order to change a system under which, due to a deeply ingrained tradition, there still prevails the principle that "everything that is not expressly authorised is to be understood as forbidden" into a new system - expected to enter into force before the end of the year - under which "everything that is not expressly forbidden should be considered as authorised".

It is of interest to make a brief reference to the liberalisation programme of capital movements which Portugal fully intends to implement by 1992 under the terms of the EC Accession Treaty.

As previously mentioned, the guidelines for foreign investment in the Portuguese stock market have been liberalised. In turn, investment funds constituted in Portugal are authorised to invest up to 10% of their portfolios in securities listed on OECD stock exchanges.

By 1 January 1990, foreign direct investment, which is currently limited, will be entirely deregulated.

By January 1991, we expect to have in place the following measures:

- Purchase by Portuguese residents of foreign securities traded on the stock exchanges, including units of UCITS (undertakings for collective investment in transferable securities), as well as of the subscription of securities issued by the Community and the EIB, will be fully deregulated.

- Real estate investments made by non-residents in the national territory will be fully deregulated.

By January 1993:

- Liberalisation of direct investments made by residents in the Community

- Authorisation to list Portuguese securities on the stock exchanges of Member States, and vice versa

- Liberalisation of real estate investments abroad by residents

- Portuguese residents will be free to purchase bonds issued on foreign markets denominated in escudos as well as other domestic securities traded on the stock exchange but issued on a foreign market.

By the end of 1992, when this process will be completed, only the guidelines concerning short-term capital movements will be in effect.

This matter has been debated by several EC authorities, is part of the so-called second stage of liberalisation of capital movements and is expected to be implemented by 1992, according to the EC Commission. Intimately associated with this project is the need to deregulate financial services.

Portugal accepts this objective but considers it essential to have a three-year transition period from 1992 to complete the process of adjustment of the financial system and deregulation of the markets in order to be ready for the full liberalisation of capital movements. Furthermore, we believe that this project should be linked with the participation of the escudo in the EMS exchange rate mechanism, to take place prior to the full liberalisation of capital movements.

THE EUROPEAN COMMUNITY: DISMANTLING INTERNAL BARRIERS - THE EFFECTS ON INDIVIDUAL ECONOMIES

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The steps towards the creation of a common market, linking the economies of the six signatories of the Treaty of Rome, were remarkably fast. Most frontier controls, especially in the form of tariffs and quantitative restrictions, were eliminated by 1968. But subsequently, the momentum was lost. The dramatic decline in economic growth and the rapid rise in unemployment, which marked the 1970s and the early 1980s, led to a resurgence of protectionist pressures and helped to dampen the enthusiasm of national political leaders for further liberalisation measures. On the other hand, the successive rounds of enlargement of the European Community, which doubled its membership from six to twelve and turned it into a more heterogeneous group in the process, diverted attention away from further integration.

The economic slowdown in Western Europe, coupled with international developments, finally brought about a shift in the political climate on the old continent. Talk of "Eurosclerosis", which was meant to describe the rigidities of European markets, the strong fear of lagging behind the United States, Japan and even the new industrial powers of the Pacific Rim, and the liberalisation pressures emanating mainly from Washington D.C., have all contributed to the rediscovery of competition and the market as the main driving forces of economic growth. Hence, the emphasis in recent years on privatisation, deregulation and the control of government expenditures as major themes in the political debate in Western Europe.

The initiative for the creation of the internal market by 1992 needs to be understood in this context. In a world of mixed economies, as the ones we live in Western Europe, the dismantling of barriers, leading to the gradual integration of national economies, cannot stop at the border. Different government rules and regulations often act as major impediments to the free movement of goods, services, persons and capital, which is the foundation of a real common market.

This is what the objective of the internal market is about: the elimination of all physical, technical and fiscal barriers in this large European market of 320 million people. Those barriers include frontier controls, different technical standards, state aids, discriminatory public purchasing, government regulation of access to national markets, especially in the service sector, exchange controls, different indirect and corporate taxes etc. etc. Most of them fall into the category of the so-called non-tariff barriers which have been for years at the top of the agenda of intra-European and international negotiations, as tariff protection became gradually less important - and in the case of the EC, it was completely eliminated.

Even a short list of the various internal barriers, which are supposed to be phased out in less than five years from now, provides a clear illustration of the enormity of the task undertaken by the European Community. Although nobody should realistically expect the complete elimination of all barriers (in some areas, such as fiscal harmonisation, progress is likely to be slower than in other areas), the target of 1992 should help to focus the mind of political leaders and economic agents.

The way of going about achieving the objective of the internal market is sometimes fundamentally different from the attitudes which had prevailed in the past. For example, the harmonisation of different national standards and regulations, which had proved an arduous and extremely slow process, has been replaced by the selective harmonisation of essential requirements, combined with the mutual recognition of each other's rules. This should lead to a situation which can be described as competition among rules. A similar philosophy characterises the recent Commission proposals for the adoption of a single European banking license based on the principle of home country control. Thus, the authorisation given by any member country of the EC should enable a bank to open branches in any other country of the Community, and the responsibility for supervision should fall on the authorities of the home country which has given the authorisation. The precondition for the introduction of such a common license, which is bound to have major effects on the European banking sector, will be the harmonisation of certain prudential rules. The Community is already moving slowly in this direction.

The new approach to harmonisation, which applies to both goods and services and forms an integral part of the 1992 target, should lead to an acceleration of the process of integration of national economies. At the same time, it should also contribute towards the creation of a more liberal and less regulated economic environment in Western Europe.

If we may use the popular jargon imported from the United States, the creation of the internal market forms part of Europe's programme of supply-side measures, and it is generally seen as such.

The dismantling of internal barriers is closely linked to a more significant redistribution of resources and the transfer of funds to the less developed regions of the Community. It is also bound to exert greater pressure, mainly through the liberalisation of capital movements, for the closer coordination of national macroeconomic policies and the eventual creation of common monetary institutions. Large swings in intra-EC exchange rates, and the uncertainty associated with them, would be incompatible with the internal market. We should, therefore, expect a further strengthening of the European Monetary System, and a number of concrete proposals are already on the negotiating table.

If the momentum is sustained (and there is bound to be strong resistance from national governments and interest groups), we should witness in the next few years a genuinely revolutionary phenomenon, namely the birth of the European economy. A European economy within which trade flows, labour mobility and cross-frontier business collaboration (including mergers and acquisitions) grow at a rapid pace. The first signs are already there. And this should take place in an economic environment characterised by a, perhaps already unstoppable, process of internationalisation of trade and production. Hence, an open European economy.

In a recently published study, the so-called Cecchini report, the Commission has estimated the economic effects of the creation of the internal market by 1992. The expected gains will take the form of, first, lower costs in intra-EC trade, associated with the elimination of frontier controls; second, lower costs of production, resulting from simpler rules and the fuller play of comparative advantage in an integrated market; third, economies of scale; and fourth, higher efficiency linked to more competition. Translated into macroeconomic figures, the gains from the internal market have been estimated as an additional 4.5% of the Community Gross Domestic Product (GDP), a reduction of inflation by 6%, and the creation of approximately two million new jobs. The dismantling of internal barriers is also expected to lead to a reduction of public sector deficits representing 2% of GDP and an improvement of the overall external balance equivalent to 1% of GDP.

In view of the expected improvement in terms of inflation, public sector deficits and the balance of payments, the EC Commission has pointed to the new possibilities created for coordinated reflationary measures which would further improve the prospects for growth. A more active macroeconomic policy could raise the overall gains from the internal market to an additional 7% of GDP and the creation of five million new jobs.

Certainly, economics is still a very imperfect science, if at all a science, and economic forecasts are as good as the assumptions on which they are based. The Commission study should, therefore, be treated as a rough indicator of the nature and the magnitude of the economic benefits associated with the creation of the internal market.

The dismantling of internal barriers will also, inevitably, imply certain costs for the economic participants. The strong winds of competition which will blow from Crete to Northern Ireland can, like cold showers, invigorate those who are already in relatively good health. But for the physically weak, there is the danger of pneumonia. Politics is mainly about distribution, about winners and losers. Therefore, the main political question regarding the creation of the internal market is about the distribution of costs and benefits among countries, regions and individual producers and consumers. This is the 100 billion ECU question for the next few years.

The further opening of national economies will expose inefficient firms, which have survived until now in protected and usually oligopolistic markets, to competition from outside. This will lead to closures, and the associated adjustment costs in terms of labour and capital for the economy as a whole. It is exactly for this reason that the Commission has stressed the need for redistribution through the EC structural funds and the adoption of more expansionary macroeconomic policies. Freeer trade is always easier to accept in times of rapid growth, and we should only hope that the governments of the major European economies, and especially the Federal Republic of Germany, will finally understand this simple truth.

For the new members of the EC, and here I also include Greece, the creation of the internal market constitutes an even bigger challenge both because of the relatively lower level of their economic development and the long history of protection, which is now in the process of being eroded as a result of their accession to the European Community. The internal market will require an additional effort of opening up, adjusting and integrating in a highly competitive economic environment.

It is very interesting that, at least in the last two years, the European South, together with Britain, has acted as a mini-locomotive for the European economy, while the continuous devaluation of the US dollar brought the earlier period of export-led growth for Europe to an end. This is expected to continue in 1988. Will this prove to be a temporary phenomenon or shall we witness a new period of rapid growth for the countries of the sunbelt, as the European market becomes increasingly unified? And will Greece be part of it? After all, this would be a continuation of the experience of the 1950s and the 1960s, the interruption of which can be attributed to domestic and international factors which are gradually eliminated.

When talking about the Greek economy, people usually think of agriculture, minerals, textiles and clothing, and services, especially tourism and shipping. However, identifying the comparative advantage of a country is a hazardous and usually self-defeating exercise, especially nowadays when comparative advantage is no longer seen as divine inheritance but rather as something created and rapidly changing. This is mainly due to the growth of firms operating at the global level, the spectacular increase in international capital movements, the transfer of technology, and the shift to knowledge-intensive industries. In this context, Greece should try to capitalise on its membership of the European internal market and its geographical proximity and good relations with the Middle East and Eastern Europe as important factors in attracting investment. It should also take advantage of the entrepreneurial abilities and the technical skills of its people, and thus try to reverse the brain drain from which it has suffered for years, because of the lack of sufficient opportunities at home.

But for potential advantages to be turned into real engines for growth, a number of conditions need to be fulfilled. They include the existence of transparent and relatively steady rules governing the economic life of the country, macroeconomic stability, a good political and social climate, a flexible and well-trained labour force and a supportive administration. These constitute the main ingredients for the creation of a dynamic economic environment and for the attraction of both domestic and foreign investment. Since some steps have been taken in this direction during the last two and a half years, there may be ground for optimism.

The creation of the internal market brings to Greece at least three concrete advantages. First of all, it will contribute towards the creation of a stable framework governing economic exchange, thus eliminating the uncertainty from which private agents have suffered for so long. This uncertainty has been, I believe, a major disincentive for investment. Second, it will accelerate the process of liberalisation and deregulation in an economy where protection and government intervention have often been irrational and self-contradictory. Last but not least, the strengthening of the redistributive function of the EC budget, linked to the creation of the internal market, will offer new, important opportunities for investment in the country and will also help to alleviate the balance of payments constraint on economic growth. It will be up to the Greeks to do the rest.

THE INTEGRATED MEDITERRANEAN PROGRAMME - THE PROMISE OF A NEW DEAL

Jerome Vignon
Director
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European Commission

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My topic, 'A New Deal', is very ambitious. We can all recall the important period when a US President, about 40 or 50 years ago, decided radically to change the approach for public policy towards growth, employment and investment. The purpose of Integrated Mediterranean Programmes is not as ambitious, which is why I entitle my speech 'The Promise of a New Deal', but it is something like the New Deal of Theodore Roosevelt. It too is an attempt to change radically the implementation of Community policies aimed at improving investment and employment, especially in the poorest Member States.

I shall divide my talk into three parts. First I shall describe what Integrated Mediterranean Programmes (IMPs) are. Secondly I shall focus on Greece's situation. Thirdly I shall draw attention to the contribution of IMPs to the global future of the European Community.

First, what are IMPs? In this map of Europe, we have designated some regions in red. These are the Mediterranean regions eligible for IMPs, a bureaucratic description of a new scheme of the Community aimed at helping development of infrastructure and private investment, especially in the southern regions of France and Italy and the whole territory of Greece. But having said that, I have not given much explanation. IMPs are a highly sensitive and political issue, directly characteristic of the new deal in Europe.

Let's make a historical point and go back to 1980, when the idea of IMPs was born. At that time the European Community was in considerable trouble. You heard from some countries remarks like "I want my money back!" Others said "Deutschland Zahlmeister Europa". You may understand that big countries were not pleased with the way their money was being expended throughout the Community budget. Other countries such as France and Italy said "What will happen to us? Spain and Portugal are entering the Community and those two countries are extremely efficient in agriculture so they will compete and beat us. We must be helped to modernise our agriculture, especially for wine and fruit in the southern, Mediterranean regions of our countries". In addition, there was a newcomer, Greece, which was entering the European Community in 1981. It said "The difficulties of France and Italy are nothing compared with our challenge. Greece is entering a new world, the European Community, and we need some assistance, some solidarity, from structural funds".

That was the crisis in the Community. On the one hand there was no more money because it was needed to pay back to the UK and because the Germans said they were already too expensive and the money was weighted; on the other hand more money was needed in order to allow the French and the Italian regions and especially Greece to cope with the new challenge of competition within the Community.

The crisis lasted four years. It could not be overcome without a fundamental change and this change was named Integrated Mediterranean Programmes. It was an approach of Jean Delors and of the European Parliament to propose a radical new attitude to expanding Community money. Delors said "We will ask for less money for the same purposes and do more but we will radically change the approach of common solidarity in policymaking for the benefit of the poorest regions of the Community".

Let me describe a little more what this qualitative change is in the new basis for policy-making in developments in the European Community.

The new approach is a multi-annual programme based method. Instead of approving single infrastructure or private investment projects on the basis of specific purposes, the Community, through IMPs, will give its agreement and support to global programmes designated by local, regional and national authorities in close co-operation. Instead of centralised management in Brussels, Athens, Paris or Rome, the management of the new programmes created by the IMPs will be integrated. It will require contribution in a co-ordinated fashion from local, regional, national and European authorities.

Last but not least, the money will not be distributed according to quotas that are guaranteed to each country, it will be distributed according to the quality and efficiency arising through the programmes. That is the novelty. We have been extremely impressed by the efficiency of employment and investment creation in the United States during the 1970s and 1980s and we have felt that part of the reason for these programmes was linked not to macro-economic but to micro-economic issues, especially the way in which local and regional authorities were themselves committed to results in making public policy work, in close co-operation with private bodies.

I must now speak about money. Having advocated a new method, it became impossible to have new money. This slide shows the shape of the new undertaking of the IMPs in the Community and represents the amount of funding which will be available from the Community's side for the purpose of IMPs during the six years from 1987 to 1992. The amount will be about 4.1bn Ecus, to which 2.5bn Ecus in the form of loans from the EIB, for example, must be added, ie in total, 6.6bn Ecus for the benefit of 30 southern regions of the Community, including the whole of Greece.

I should note that one Ecu is worth US$1.1 or US$1.15, depending on the monthly external figures for the US. Thus this is a considerable amount of money.

The money is necessary, it is a way of acting on a Community basis to face new world competition, but it is just a means, a tool. In the case of Greece, I should like to emphasise that IMPs, which have been operative since 1986, provide an opportunity to accelerate important moves within the Greek economy and administration which seem to be needed according to previous interventions. That is most important, for Greece and for the Community.

In the framework of the IMPS, two very important developments, already at work in Greece, will be encouraged. Since the beginning of the 1980s the Greek government has been trying to reconcile the historic traditions and constraints of Greece with its membership of the European and world economic community. To reconcile means to move and to change. I would characterise those changes in two main issues which are directly encountered by the IMPs.

The first move is towards a more decentralised, flexible organisation of administration. Indeed, seven IMPs have already been set up in Greece and each has been shaped according to local and regional purposes.

Each of those seven IMPs is separate, relying on a follow-up committee based in each region. The chairman of the monitoring committee of each IMP is a periferiarch, ie a secretary for regions. National, regional and local authorities and authorities from Brussels belong to this monitoring committee, which meets every three months in order to monitor progress in the implementation of the programmes devoted to infrastructure and productive investment. This is a sort of silent revolution.

The second important move which also accompanies the IMPs is towards a slight change in the methods of establishing public policy. Greece is in the course of modifying the main elements of public policy, especially since 1985.

Let me take the example of industry. Previously assistance to develop industry was provided through direct subsidies for exports or eventually through protection against imports via discriminatory taxation. The IMPs will help, and already have helped, to replace this kind of instrument with direct investment subsidies which are of a quite different and more efficient nature.

Earlier today we heard about venture capital in Portugal. It is also something that will develop within the framework of IMPs. There is a project to create three different companies of venture capital risk in our fund within the framework of the Attic IMP. On the part of the Commission, we expect that a new law allowing this kind of company to be created will be approved by the Greek parliament before the end of 1988.

Of course, I must not describe the situation too optimistically. We face considerable difficulties. For example, in the kind of partnership established between the Community and Greece in the framework of IMPs, we are not very happy with the annual public budgeting which makes it difficult to programme multi-annual investment projects in the framework of IMPs. The European Community, as a partner, must also support some rapprochement. We think that both the Community and Greece are committed to success. It is not as in the past when the Community, having given its money, thought that it had done its best. We are now engaged with Greece in a process towards success.

In conclusion, I wish to underline that success of IMPs in Greece in the years to come will have implications far beyond Greece and IMPs. We have heard from earlier speakers of the kind of challenge the Community faces before 1992. We are not only trying to make the single market work, we are simultaneously changing the total pattern for implementing European common structural policy.

Some people have raised questions on the doubling of structural funds. I recall that two months ago the heads of government in Brussels decided effectively to double the size of structural funds, ie the amount of money that would be available to help the poorest countries, as well as countries in difficulty, to adjust structurally. The money involved is about 2bn Ecus each year until 1992 instead of the 5bn Ecus it would have remained under the previous terms. This new money will be implemented on a pattern directly inspired and managed under the model of the IMPs - a model based on partnership, programming, quality and efficiency and on the role of local and regional authorities. That is why we need success for the IMPs. They represent the future of the whole solidarity of structural policies in the Community.

I think IMPs will be a success because they have already helped us - not only the Greek government but also the civil servants, services and administration in the Community - to be more supportive. They have helped us to change our minds and to change our way of acting and proposing new initiatives, giving a role to private and local partners, and change is now most important. In a changing world, a changing Europe and a changing Greece, the famous question "To be or not to be?" becomes "To change or not to change?"

Annex 1 Community assistance approved – Greek IMPs 1986/88

(million ECU)

IMP	TOTAL EXPENDITURE	COMMUNITY BUDGET						NATIONAL PUBLIC SOURCES	PRIVATE SOURCES
		TOTAL	ARTICLE 551	EAGGF	ERDF	ESF	FISHING		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Crete (2)	199,4	93,0	35,5	19,9	37,4	0,2	-	28,4	78,0
Western Greece and the Peloponnese	229,1	126,8	38,7	20,1	63,0	4,3	0,7	64,2	38,1
Northern Greece	288,8	165,9	54,1	33,4	71,4	7,0	-	88,5	34,4
Central and Eastern Greece	133,3	75,3	23,1	12,9	36,6	2,7	-	39,2	18,8
Attica	144,4	81,2	72,3	1,2	0,5	7,2	-	47,5	15,7
Aegean Islands	132,5	83,7	24,6	4,4	53,9	0,8	-	46,1	2,7
Information technologies	53,7	35,6	24,5	-	8,8	2,3	-	18,1	-
TOTAL	1181,2	661,5	272,8	91,9	271,6	24,5	0,7	332,0	187,7

(1) Not included in the financial plan.
(2) 1986/87.

nex 2 Community assistance approved - Greek IMPS 1986/92

(million ECU)

IMP	TOTAL EXPENDITURE	COMMUNITY BUDGET TOTAL*	ARTICLE 551	EAGGF	ERDF	ESF	FISHING	NATIONAL PUBLIC SOURCES	PRIVATE SOURCES	EIB(1)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
ete	463,9	240,5	102,5	50,4	86,7	0,9	-	228,4	-	140,
stern Greece and the Peloponnese	631,3	361,3	105,8	82,1	153,0	19,0	1,4	179,3	90,7	125,
rthern Greece	695,8	436,8	154,5	72,1	150,3	29,9	-	204,9	84,1	120,
ntral and Eastern Greece	550,1	315,6	86,5	58,4	159,3	10,3	0,6	174,0	60,5	117,
tica	407,9	223,1	203,5	2,2	0,6	16,8	-	127,5	57,3	74,
gean Islands	325,2	193,5	59,5	15,4	114,4	4,1	0,1	103,3	28,4	67,
formation technologies	134,2	88,3	52,8	-	26,6	9,4	-	45,4	-	12,
TAL	3213,4	1829,6	765,1	280,6	691,4	90,4	2,1	1062,8	321,0	655,

(1) Not included in the financial plan: provisional information which has not yet been made the subject of an EIB letter of intent.
* 170 m ECU not yet allocated and remaining in reserve for industrial investment.

IMP for Attica

SUBPROGRAMMES	1986-88 million ECUs	1989-92 million ECUs	TOTAL million ECUs	TOTAL %
1. Industry	38,22	112,26	150,48	36,90
2. Tertiary sector	26,43	28,54	54,97	13,48
3. Infrastructure	70,02	108,74	178,76	43,09
4. Less developed areas	5,37	18,14	23,51	5,76
5. Implementation	1,35	1,80	3,15	0,77
Total expenditure	144,39	263,49	407,88	100,0

IMP for the Aegean Islands

SUBPROGRAMMES	1986-88 million ECUs	1989-92 million ECUs	TOTAL million ECUs	TOTAL %
1. Reducing the isolation of the islands	62,96	70,61	133,57	41,08
2. Containment of large concentrations of tourists	26,77	13,56	40,33	12,40
3. Promotion of low-density tourist developments	23,92	59,48	83,40	25,65
4. Primary sector	17,47	47,19	64,66	19,89
5. Implementation	1,35	1,85	3,20	0,98
Total expenditure	132,47	192,69	325,16	100,0

Imp for information technologies

SUBPROGRAMMES	1986-88 million ECUs	1989-92 million ECUs	TOTAL million ECUs	TOTAL %
1. Infrastructures and basic structures	6,93	6,78	13,71	10,22
2. Research	11,05	8,46	19,51	14,54
3. Development of industrial capacity	4,70	5,80	10,50	7,83
4. Application in the primary economic sectors	14,78	24,19	38,97	29,05
5. Application in public administration	14,83	33,13	47,96	35,75
6. Implementation	1,45	2,05	3,50	2,61
Total expenditure	53,74	80,41	134,15	100,00

Annex 3 : Greek IMPs

Imp for Crete

SUBPROGRAMME	1986-87 million ECUs	1988-92 million ECUs	TOTAL million ECUs	TOTAL %
1. Primary sector	42,2	75,5	117,7	25,10
2. Tourism	30,3	17,7	48,0	10,24
3. Industry, etc.	64,5	90,7	155,2	33,10
4. Inner areas	11,1	24,7	35,8	7,63
5. Infrastructure				
- communications	18,0	18,4	36,4	7,76
- health care and social services	6,9	4,5	11,4	2,43
- education and training	7,5	13,1	20,6	4,39
- other	17,7	21,9	39,6	8,45
6. Implementation	1,2	3,0	4,2	0,90
Total expenditure	199,4	269,5	468,9	100,00

Imp for Western Greece and the Peloponnese

SUBPROGRAMME	1986-88 million ECUs	1989-92 million ECUs	TOTAL million ECUs	TOTAL %
1. Agricultural sector	28,40	93,88	122,28	19,36
2. Inner areas and islands	27,93	54,14	82,07	13,00
3. Marine and fishery resources	11,63	18,93	30,56	4,84
4. Tourist development	22,46	42,42	64,88	10,28
5. Industry and the energy sector	83,05	133,17	216,22	34,25
6. Infrastructure	53,50	56,82	110,32	17,47
7. Implementation	2,14	2,86	5,0	0,80
Total expenditure	229,12	402,20	631,32	100,0

FOREIGN INVESTMENT AND CAPITAL FLOWS:
AN INTERNATIONAL PERSPECTIVE

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Nicholas Nanopoulos: World Bank

FOREIGN INVESTMENT AND CAPITAL FLOWS: AN INTERNATIONAL PERSPECTIVE

I INTRODUCTION

International capital flows and foreign investment serve as catalysts in the process of economic development. Movenment of capital does not take place in a vacuum but in an institutional set-up called "financial markets". "Financial markets" is a very loose term encompassing a wide range of institutions, instruments, codified and uncodified rules of behavior and participants. Our vantage point in todays discussion is international capital flows, foreign investment and financial markets. We shall attempt to analyze their structure and evolution both in a global context and in the context of the Greek economy. The purpose is to hopefully reach some meaningful conclusions on policy and future developments.

First we shall examine the evolution and behavior of financial markets and how they can impact economic decisions and policy making. Next we shall look at international capital flows and foreign investment both from a historical and structural perspective and decide how the Greek economy fits in the pattern of international movement of capital. We shall further analyze the rationale for foreign direct and portfolio investment and their development pattern in the case o Greece. Finally, we shall draw some conclusions not only on policy issues but also on the future of private finance in Greece.

II FINANCIAL MARKETS

In the past ten years or so, financial markets have expanded very rapidly in order to accomodate the pressing financing needs of widening current account and budget deficits. Those deficits stemmed in part from the oil shocks of the seventies. Capital flows were also facilitated by a wave of financial deregulation and liberalization that has led to the creation of a more globalized financial system. The dismantling of barriers on capital flows went hand in hand with a tedency of policy makers to rely more on market forces such as interest rate and exchange rate adjustments in their conduct of economic policy.
At the same time, technological progress in the area of information processing has allowed information to be disseminated instantaneously and capital to be transferred and transformed electronically and at low cost. All those

developments have resulted in an unprecedented degree of asset price volatility. Heightened volatility has in turn induced market participants to develop protective mechanisms to safeguard the integrity of their balance sheets. Those mechanisms took the form of securitization or marketability of assets and of hedging techniques for market risk.

The evolution of financial markets mirrors changes in prevailing economic conditions.That appears to be self evident. What is more important is that the behaviour of financial markets, given the critical role that they play in the transfer of information and the formulation of expectations, has an increasingly decisive impact on economic variables and on policy making. What took place on the floor of the New York Stock Exchange on October 19,1987 affected both economic decisions and policy all over the world. The resources that Central Banks can muster to intervene in currency markets are dwarfed by the $200.0 daily volume traded in foreign exchange. Every day market participants have a chance to cast their vote of approval and disapproval on economic policy, by changing the relative value of assets. That vote is then transmitted electronically across the globe to more and more decision makers. Markets have become the watchful guardians of their self-defined economic disciopline. Consequently,the market imposed economic descipline will increasingly have a bearing on economic decisions and policy even for countries as geographicaly distant from the epicenter of markets as Greece.

III THE STRUCTURE OF INTERNATIONAL CAPITAL FLOWS

a. Introduction

International Capital flows are needed by developing countries to supplement domestic investment and promote faster growth and to cushion their economies from internal and external shocks. Excessive reliance on foreign borrowing can be counterproductive and destabilizing and has led to the current international debt crisis. A high level of foreign indebtedness can be particularly harmful if combined with flawed economic policies such as an overvalued exchange rate or an unsustainable budget deficit. There are essentially two key questions that any country needs to address in the design of its financial strategy. How much to borrow from abroad and in what form.

b.Categories of Capital Flows

As to the form of foreign capital, there are essentially five

categories of international capital flows.
(i)official development flows,which as the term implies, originate from rich countries or public organizations and serve the development objectives of low income countries, (ii)commercial bank lending which is a more flexible source of private finance and includes syndicated euroloans (iii)Portfolio investment which involves the purchase of stocks, bonds or other financial assets by foreigners who hold no controlling interest in the organizations whose securities they purchase(iv)Foreign direct investment which involves the purchase of productive assets by a foreign firm that exercises management control over that investment,(v) and other sources that include export credits and investments in convertible currency from nationals living abroad.

c. Historical Review

Next, we shall proceed with a brief historical review of global capital flows over the past ten years. International bank lending,principally through syndicated loans, became the most significant source of funding for cash starved oil-importing and other developing countries in the late seventies and early eighties. With the onset of the debt crisis in 1982, the perceived creditworthiness of a number of developing countries suddenly deteriorated leading to a sharp contraction in syndicated lending. As illustrated by the table ( ) syndicated loans which stood at $82.0 billion in 1980 declined to $43.0 billion in 1985. Since 1985, syndicated lending has revived somewhat mainly due to corporate demand. Concern by commercial banks with their own capital adequacy will probably continue to suppress their appetite for new sovereign debt.

With international commercial banks reappraising their strategy on sovereign lending, international securities markets provided a new source of international finance. Deregulation, securitization and financial innovation gave the impetus for the creation of new marketable instruments, such as NIFs or ECP, designed to fit the needs of international borrowers and investors. Between 1980 and 1987, the volume of internationally marketable securities expanded sevenfold from $43.1 billion to $ 295.0 billion. What we conclude therefore, is that after the demise of syndicated lending to developing countries, portfolio flows have become the principal means for the transfer of capital across countries.

With regard to FDI flows they grew very rapidly in the late seventies and reached
a peak of $65 billion in 1981. The international debt crisis depressed the volume of foreign direct investment during the period 1982-84. In the last few years FDI flows have expanded again and reached their previous peak.

d. The Structure of Private/ Autonomous Capital Flows

The rapid expansion in international finance has masked the fact that the composition of capital flows, for any given country, is a function of how economically advanced it is. After weaning itself from official development assistance, a country relies more heavily on commercial bank lending and enjoys some inflow of FDI. FDI is thus the initial source of autonomous private capital. It is only at a later stage in its economic development that a country is typically able to attract portfolio capital flows.In fact, as shown on the projected chart ( ) , only about 8% of all portfolio investment goes to developing countries.

This new chart ( ) schematically illustrates the relationship between FDI and PI flows as a function of a country's economic development process.Curve A shows the net FDI position of a country (inflows-outflows).Curve B shows the net PI position of a

country (inflow - outflow).Curve C is simply the sum of curve A and B. Two things are quite obvious. First, that at the early stage in their economic development, countries experience a net inflow of foreign capital which they repay as their development progresses.Second, that FDI is a relatively more significant source of capital at the early stage of development compared with PI, which becomes more important later, as the economy matures. This analysis leads us to distinguish five stages in a country"s development process.

STAGE I: Developing Economy (Turkey, Brazil, Argentina)

At that stage countries experience substantial capital inflows in the form of official development assistance, commercial lending and FDI. They do not have substantial portfolio capital inflows because their capital market is still underdeveloped.

STAGE II: Young Debtor Economy (Greece, Portugal)

At that stage countries reach their peak in inward FDI and start receiving some capital in the form of portfolio investment, as their domestic capital market develops. They also begin to engage in some outward investment.

STAGE III: Mature Debtor Economy (Spain)

At that stage countries start to develop indigenous multinationals that invest overseas, and to rely much more heavily on portfolio capital inflows.

STAGE IV: Developed Economy (France, Italy, Sweden)

At that stage countries become aggressive outward foreign direct investors. They also start making more significant outward portfolio investments.

STAGE V: Net Creditor Economy (Japan, Germany, U.K.)STAGE V: Net Creditor Economy (Japan, Germany, U.K.)

At that stage countries become net outward investors (for both FDI and PI) and enjoy a net creditor status.

This model would lead us to the following conclusions regarding future developments in Greek capital markets:

First, there is scope for further expansion of inward FDI in

Greece, but that the expansion will level off within the next few years. Second, Greece is at a stage where its financial markets are liable to expand very rapidly and provide opportunities for portfolio investment.

IV FOREIGN DIRECT INVESTMENT

So far we have made a historical review of international capital flows worlwide and looked at the structural behaviour of foreign direct and portfolio investment, for a cross section of countries. Now we shall turn our attention to the rationale for foreign direct and portfolio investment and look at their past behavior and future prospects in Greece.

Foreign direct investment is undertaken by multinational firms that enjoy a competitive advantage such as superior product design, more advanced technology or a more efficient distribution network, in recipient countries that possesss some comparative advantage in relation to alternative production sites. In addition to having a favorable political and regulatory environment, recipient countries should possess some of the following characteristics: A large and expanding national or regional market, a skilled and competitive labor force, a well developed infrastracture or cheap natural resources. In sum, FDI is driven by a combination of "push" factors that have to do with the expertise and technological abilities of the investing firm and "pull" factors associated with the attractiveness of the recipient country as a production base.

Is FDI beneficial or detrimental to the recipient country?

A historical appraisal of the benefits and costs of FDI would be imprecise tedious and of limited use. For a developing country that needs to attract foreign capital to promote its economic development the relevant question becomes one of defining the conditions that would render the foreign investment mutually beneficial. According to the experience of the World Bank, under an appropriate policy environment, FDI can be beneficial to recipient countries. Recently even countries such as China or the Soviet Union have allowed themselves to be courted by multinationals.
The geographical distribution of FDI defies conventional wisdom. FDI does not flow from rich countries to poor countries. It flows primarely from rich countries to other rich or middle income countries. In absolute terms, the largest recipients of inward FDI in the world are the United States, Canada, the U.K. and W. Germany, in part because of the size of their economies.The value of FDI assets in the U.S. was about $192 billion in 1985 and probably exceeds $250 billion by now. This is about 150 times larger than FDI assets in Greece!

Even in relative terms, for several industrialized countries FDI accounts for a large share of domestic sales in manufacturing: 50% for Canada, 41% for Belgium and 33% for the Netherlands.Among developing countries, Latin American countries seem to attract relatively more FDI than their Asian counterparts.

In Greece the book value of the assets controlled by multinationals is roughly estimated at about $1.6 billion Moreover, their market share in manufacturing is estimated at about 24% of domestic sales. Among Greece's closest competitors, Ireland and Spain have a higher foreign penetration, with 45% and 37% of their manufacturing sales controlled by foreign subsidiaries. Portugal and Turkey have a lower market penetration with 17% and 7% respectively.
During the past 35 years,Greece's legislative and regulatory environment has generally been supportive of foreign direct investment. FDI, however, only took off in the early sixties and grew rapidly until the mid-seventies. Since that time, FDI flows have been relatively modest and in fact there has been some disinvestment because of the acquisition of some foreign subsidiaries by the state (e.g.Esso Complex, Hellenic shipyeards). It is noteworthy that the period of intensive FDI coincides with the period of rapid industrialization, a phenomenon that has been more widely observed in several developing countries.

Foreign investment in Greece has been concentrated in high technology industrial sectors such as chemicals,pharmaceuticals,petroleum products,basic metal industries, transport equipment and electrical machinery and appliances. In all those sectors it is estimated that about 50% or more of domestic sales are accounted for by subsidiaries of foreign firms. Moreover, those sectors tend to exhibit a high import propensity. It is therefore not surprising that FDI in Greece has been principally import substituting in character, benefiting from the high protective tariffs that existed when most multinationals in Greece were initially set up. It has also been estimated that $1 in domestic sales by foreign subsidiaries displaces about 55 cents in imports.
There have been two additional motives for FDI in Greece. First investments linked to natural resources in the aluminum, cotton, food and beverage industries.Second, purely export oriented investments in the textile, footwear and apparel industries, attracted primarily by Greece's relatively low wages.

With Greece being part of the European integrated community, import substitution can no longer serve as the principal motive for FDI. The emerging environment is prone to attract export oriented investments, for which one could identify three alternative strategies:

The <u>" cheap sourcing strategy"</u> advocating that Greece's low wages would attract EEC firms to produce labor intensive products or components.

The "trojan horse" strategy maintaining that non-EEC firms from the U.S. or Japan would establish a foothold in Greece to make inroads into EEC markets.

The "bridge strategy" finally arguing that multinationals would implant their subsidiaries in Greece in order to serve regional Middle Eastern and N.African markets, because of its proximity

and its relative political stability.

FDI would be supported by a macroeconomic policy environment that would be outward looking and export promoting. This in turn would imply a lower budget deficit to reduce the crowding out effect of the public sector and a devaluation of the currency that would render domestically produced goods more competitive abroad.

V. PORTFOLIO INVESTMENT

From the standpoint of an individual investor, portfolio investment in a foreign market will be deemed beneficial if he can reduce total risk through portfolio diversification for a given level of expected returns. Diversification will be most beneficial the more negatively correlated the home market is with the foreign market.

The type of risks that a foreign investor would consider in his investment decision are: currency risk; political risk; liquidity risk;and investment specific risk.. Several studies conducted on developed capital markets clearly demonstrate that there are benefits to international diversification for both stock and bond portfolios. Those studies also show that superior results are obtained for currency hedged foreign portfolios that have removed the currency risk. There is no empirical evidence so far on the benefits of diversification into the so called emerging markets such as Greece. However, as you can see from the attached diagram ( ) the Greek stock market is very negatively correlated with the U.S. stock market, something that would argue favorably for diversifying into the Greek stock market.

From the standpoint of the recipient country, portfolio investment offers an alternatine source of foreign capital, a potentially lower cost of funding, and a different risk class of investors who may expand the range of opportunities for the domestic economy. At the same time, portfolio investment can be short term oriented and unstable. For example, in 1985, in the midst of the debt crisis, portfolio investment in Argentina,Brazil and Mexico was negative for all three countries.

The size of world capital markets was approximately $13.4 trillion at the end of 1986, $6.4 trillion of that was in equities. By comparison, the size of all so-called "emerging stock markets" comprising the not so well developed stock markets of the world was $130 billion. The capitalization of the Greek stock market stood at $1.1 billion at the end of 1986, but grew to $4.4 billion at the end of 1987. There are 116 companies listed on the Athens stock exchange, and the trading value for 1987 was $460 million. The turnover ratio, a measure of the

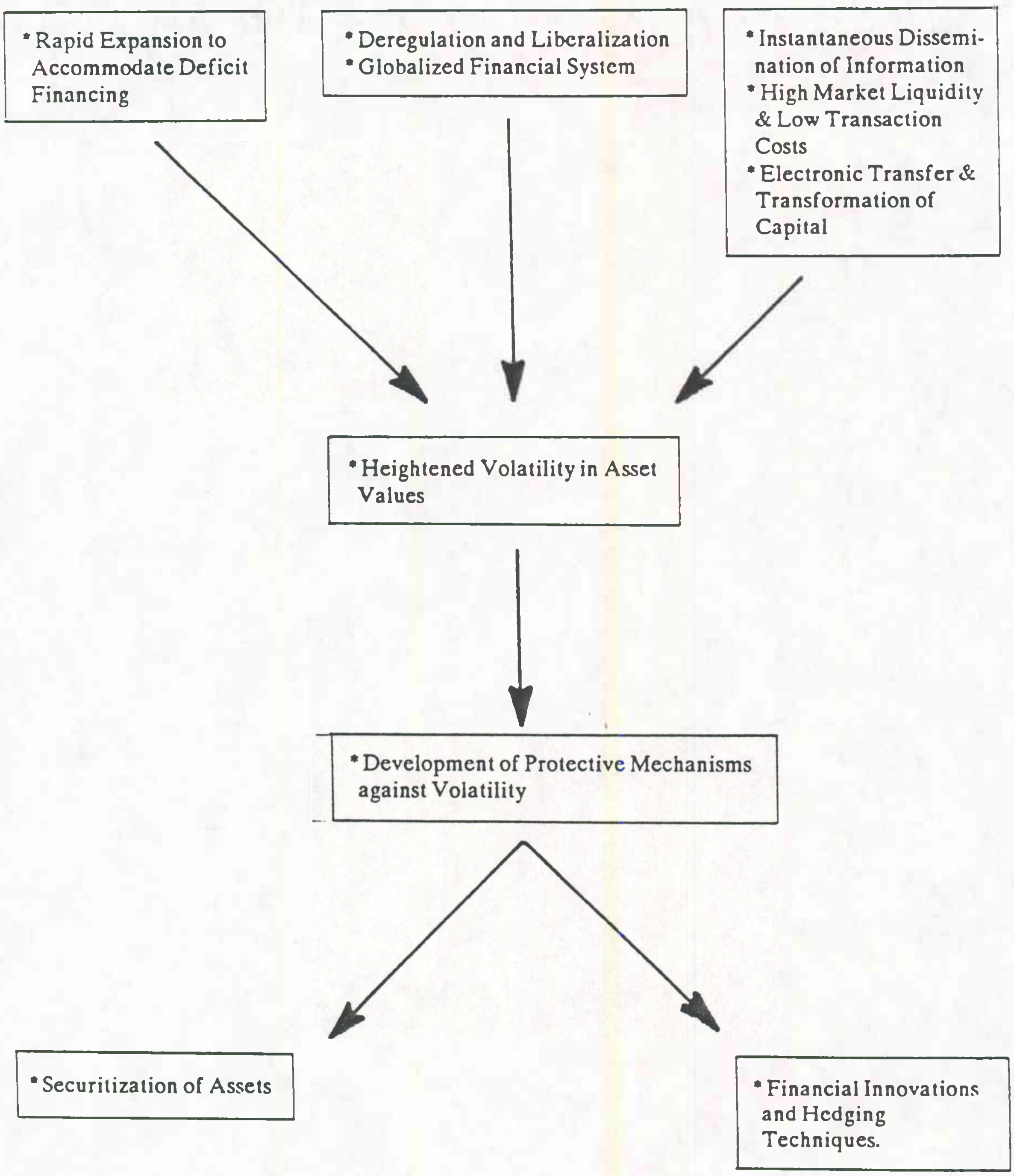
intensity of the trading volume has hovered between 1 and 3, during the last seven years.
The projected table ( ) shows the capitalization of a number of developed and emerging stock markets for the period 1980-1986.
The capitalization of the Greek stock market is still very small by international standards, in part because of the limited number of companies listed, but principally because the stock markets in Greece is not used extensively for the mobilization of risk capital. Thus,compared to Greece's per capita imcome the ratio expressing the number of outstanding shares to GNP is rather low, relative to other countries. Also low is the volume of transactions conducted on the stock market.
This brief overview of the Greek stock market shows without any doubt that there is considerable scope for growth and expansion. Current governmental efforts to modernize and rationalize the institutional framework governing financial markets should prove beneficial to the stock market.

CONCLUSIONS

Through its accession to the EEC, Greece thrust itself onto the world economic scene and strengthened its links to the world economic system. The implication from that historic decision was that it reduced the degrees of freedom in domestic economic policy making. Greek economic policies can no longer be entirely incongruous with Community policies nor totally oblivious to the opinion of financial markets. We have argued that financial markets have grown in size and stature and can affect economic policy.
In the last two years the Greek economy embarked on a program of gradual financial liberalization, both internal through the relaxation of credit controls and external by easing some restrictions on international capital flows. At the same time, a more constructive attitude toward FDI was adopted. More recently, there have also been some discussions regarding the privatization of some of the heavily indebted companies. One would expect this trend to continue in light of the full integration of the EEC countries in 1992.
Against this backdrop,inward FDI should resume its upward growth,

co ncentrated mainly in export orinted projects. There is a lot more scope for expansion of portfolio investments, given the relatively early stage of development of domestic capital markets and Greece's position on its growth cycle. The dangers of excessive reliance on portfolio investment to fund the current account deficit have been underlined. The risks confronting a foreign investor in Greece today stem from the fragility of its macroeconomic situation, with high budget and trade deficits during a period of convalescence from a program of economic austerity and stabilization.

Evolution of Financial Markets



Classification of International Capital Flows

I. **Official Development Flows** (e.g. World Bank, bilateral aid)

. Funds originate from rich countries or public originations

. Development oriented

II. **Commercial Bank Lending** (e.g. syndicated loans)

. Private

. Usually initiated by borrower

III. **Portfolio Investment** (e.g. purchase of stocks and bonds)

. Private and autonomous

. Investment in financial assets channeled through securities market

. No management control over investment

IV. **Foreign Direct Investment** (e.g. investment in plant and equipment)

. Private and autonomous

. Investment in tangible productive assets

. Not readily marketable

. Management control over investment

V. **Other** (e.g. export credits and investments by nationals living abroad).

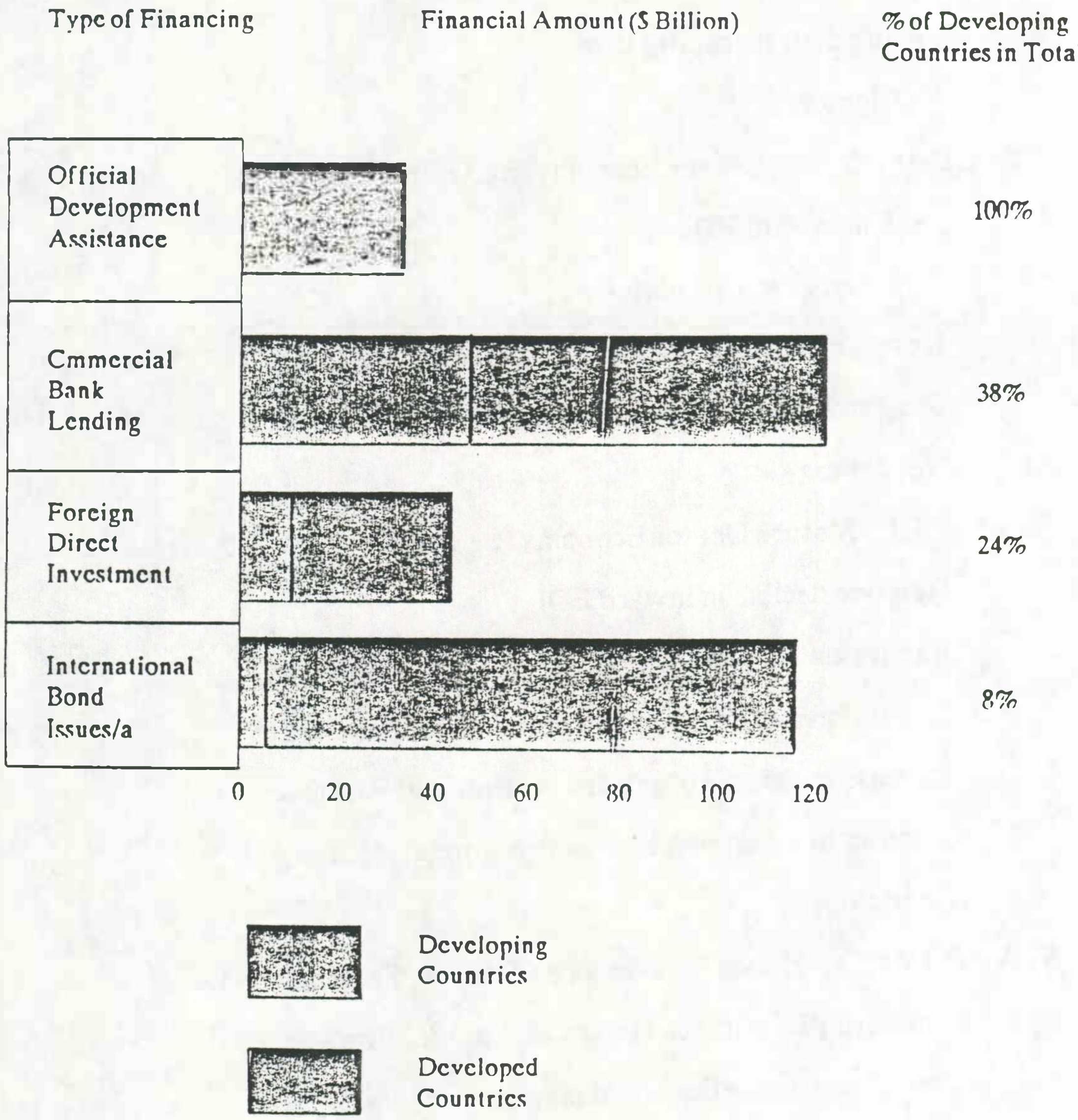
Financing in International Capital Markets by Type of Major Instrument ($ Billion)

	1980	1984	1985	1986	1987
I. Syndicated Loans	82.0	57.0	43.0	52.8	88.8
II. Total Internationally/a Marketable Securities	43.1	140.3	237.9	336.7	295.0
a. International Bonds (Foreign & Eurobonds)	43.1	111.5	169.1	228.1	177.3
b. Note Issuance Facilities (NIFs)	0	28.8	42.9	29.3	29.9
c. Euro-commercial Paper (ECP)	0	0	23.2	67.6	69.6
d. International Equities	0	0	2.7	11.7	18.2
III. Foreign Direct Investment	52.0	56.2	59.3	65.4	–
IV. Grand Total	177.1	253.5	340.2	454.9	–
Memo Item:					
% Marketable Securities in Total	24	55	70	74	–

Source: OECD

a/ Subsumed under Portfolio Investment

Financing of the Current Account Deficit for Developed and Developing Gountrics
Average Annual Flows 1978-1985 ($ Billion)



a/ Subsumed under Portfolio Investment

The Private/Automous Capital Flows Cycle Model

STAGE I: Developing Economy (e.g. Turkey, Brazil, Argentina)

. Reliance on syndicated loans and official development assistance

. Large and expanding inward FDI

. No significant outward FDI

. Underdeveloped domestic capital market

. Small portfolio capital flows

. Net debtor

STAGE II : Young Debtor Economy (e.g. Greece, Portugal)

. Peak in inward FDI

. Some outward FDI activities

. Development of domestic capital market

. Some inward portfolio capital flows

. Net debtor

STAGE III: Mature Debtor Economy (e.g. Spain)

. Relative decline in inward FDI

. Expansion in outward FDI

. Expansion and deepening of domestic capital market

. Increase in volume of inward portfolio capital flows

. Significant slowdown in growth of foreign debt

. Net debtor

STAGE IV: Developed Economy (e.g. Sweden, France, Italy)

. Outward FDI outpace inward FDI capital flows

. Developed domestic capital market

. Expansion in volume of outward portfolio investment

. Beginning of paydown of foreign debt, but probably still net debtor

STAGE V: Net Creditor Economy (Japan, Germany, U.K.)

. Large outward FDI flows

. Outward outpace inward portfolio capital flows

. Mature capital market
. Net creditor

Rationale For Foreign Direct Investment

I. Competitive Advantages of Multinational Firms ("Push Factors")

* Superior Product Design
* More Advanced Technology
* Better Production Process
* Better Marketing and Distribution Channels
* Cheaper Source of Capital
* Other

II. Comparative Advantages of Recipient Countries ("Pull Factors")

* Favorable Political and Regulatory Environment
* Large and Expanding National or Regional Market
* Skilled Labor Force
* Competitive Wages
* Well Developed Infrastructure
* Cheap Natural Resource
* Other

Estimate of Percentage of Inward Foreign Direct Investment Sales, Imports and Exports as a Fraction of Total Greek Industrial Production by Industrial Sector.

Industrial Sector	Foreign Investment %	Imports %	Exports %
Food	5	23	21
Beverages	24	3	17
Gigarettes & Cigars	0	1	1
Textiles	5	14	20
Apparel & Footwear	8	2	47
Wood & Cork	6	29	8
Furniture	2	3	4
Pulp & Paper	22	61	5
Printing & Publishing	0	5	2
Leather	16	4	12
Rubber & Plastic Products	24	19	5
Chemical Industries	56	67	24
Petroleum & Coal	71	21	14
Non-Metallic Mineral Products	12	12	25
Basic Metal Industries	58	38	23
Fabricated Metal Products	15	25	15
Machinery	7	317	6
Electrical Machinery & Appliances	53	58	13
Transport Equipment	52	479	15

ESTIMATES OF INWARD FOREIGN DIRECT INVESTMENT (FDI) ACTIVITY INDUSTRIALIZED & DEVELOPING COUNTRIES

	FDI Capital Stock ($ billion)			Market Penetration of Foreign Affiliates in Manufacturing (1983)	Source Countries of FDI in % of Total		
	1975	1980	1985	%	US	EEC	Japan
Belgium	4.2	8.5	11.3	41	44	38	5
Denmark	1.0	1.4	2.0	13	22	39	2
Germany	27.8	38.6	49.8	20	40	48	6
Japan	1.8	3.2	7.0	2	64	17	-
Netherlands	13.2	20.4	26.4	33	35	32	4
Sweden	1.1	1.5	2.2	15	27	49	4
U.K.	24.0	43.8	55.2	25	57	16	5
U.S.	27.6	110.0	192.0	11	-	62	14
Argentina	2.0	5.2	8.0	29	37	32	8
Brazil	8.5	17.2	24.8	42	32	31	9
Colombia	0.9	1.2	3.1	44	65	21	2
Mexico	4.8	10.0	15.6	38	66	17	6
Indonesia	2.3	4.0	5.5	24	6	9	37
South Korea	0.6	1.0	1.8	12	31	10	56
Malaysia	0.8	2.0	2.5	32	15	18	27
Thailand	0.8	1.4	2.5	23	30	12	28
Ireland	2.2	3.0	3.8	45	60	36	1
Portugal	0.3	0.6	1.1	17	15	55	2
Spain	2.7	5.1	8.2	37	25	41	2
Turkey	0.3	0.5	0.8	7	17	53	4
GREECE	1.1	1.5	1.6	24	42	45	5

Capital Flows Associated with Inward Foreign Direct Investment and Portfolio Investment in Selected Developing Countries (In million SDRs)

	1975	1980	1985	1986
Argentina				
Inward Direct Investment	70	523	952	-
Portfolio Investment	-46	118	-496	-
Brazil				
Inward Direct Investment	1,073	1,470	1,341	-
Portfolio Investment	-	272	-231	-
Colombia				
Inward Direct Investment	33	121	1,008	574
Portfolio Investment	-1	1	2	2
Mexico				
Inward Direct Investment	502	1,678	494	763
Portfolio Investment	126	-57	-995	-461
Indonesia				
Inward Direct Investment	992	138	270	-
Portfolio Investment	-	36	-33	-
South Korea				
Inward Direct Investment	47	6	227	365
Portfolio Investment	-	31	965	265
Malaysia				
Inward Direct Investment	14	718	682	452
Portfolio Investment	-	-8	330	510
Thailand				
Inward Direct Investment	71	143	158	218
Portfolio Investment	1	74	876	-27
Ireland				
Inward Direct Investment	130	220	159	138
Portfolio Investment	93	138	1,029	1,619
Portugal				
Inward Direct Investment	94	121	249	204
Portfolio Investment	-5	-6	95	343
Spain				
Inward Direct Investment	253	1,147	1,920	2,934
Portfolio Investment	-72	60	231	1,039
Turkey				
Inward Direct Investment	126	14	97	107
Portfolio Investment	-	-	-	-
GREECE				
Inward Direct Investment	80	40	35	75
Portfolio Investment	-	-	-	-

Source: International Monetary Fund
1 SDR : 1.38 US Dollars

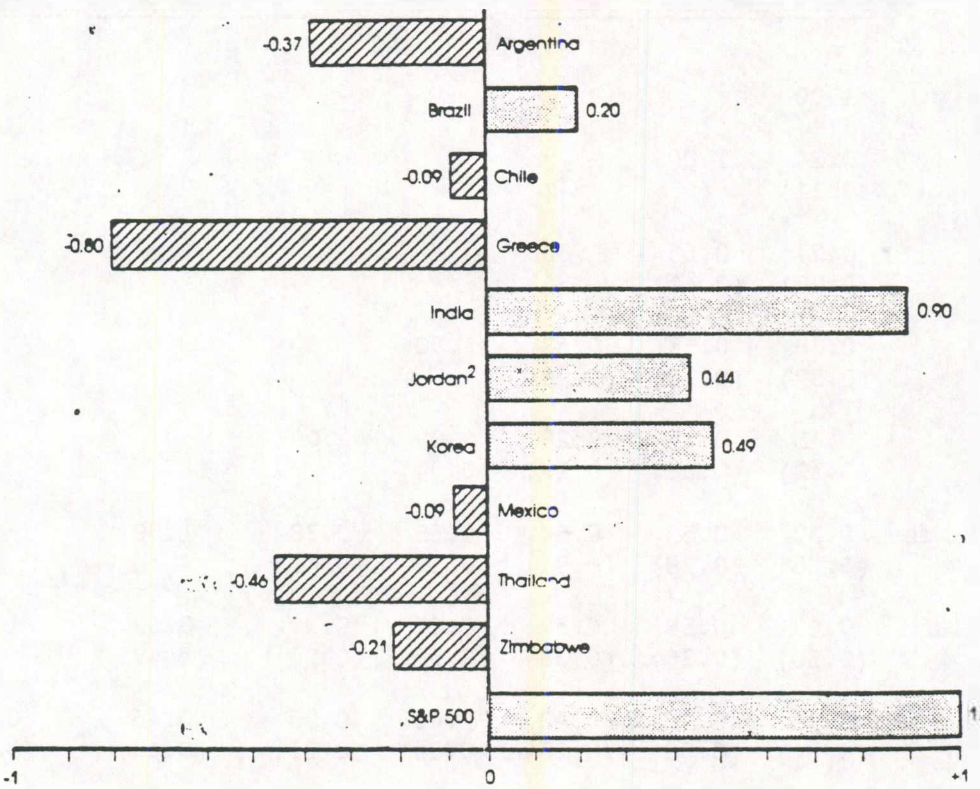
EXHIBIT 3

CORRELATION MATRIX OF INTERNATIONAL EQUITY RETURNS
FOR THE PERIOD 1980 - 85

(Currency Hedged Equity Returns are in Parenthesis)

	U.S.A.	Belgium	France	Germany	Italy	Netherlands	Switzerland	Japan	U.K.
U.S.A.	1.00								
Belgium	0.24 (0.11)	1.00							
France	0.27 (0.27)	0.56 (0.41)	1.00						
Germany	0.38 (0.37)	0.51 (0.30)	0.53 (0.28)	1.00					
Italy	0.15 (0.12)	0.15 (0.08)	0.28 (0.19)	0.09 (0.04)	1.00				
Netherlands	0.32 (0.28)	0.55 (0.38)	0.54 (0.31)	0.65 (0.52)	0.38 (0.43)	1.00			
Switzerland	0.43 (0.50)	0.58 (0.36)	0.57 (0.38)	0.75 (0.59)	0.20 (0.20)	0.63 (0.49)	1.00		
Japan	0.31 (0.34)	0.46 (0.30)	0.43 (0.23)	0.45 (0.36)	0.35 (0.21)	0.46 (0.45)	0.53 (0.37)	1.00	
U.K.	0.42 (0.46)	0.40 (0.34)	0.41 (0.31)	0.42 (0.47)	0.44 (0.40)	0.35 (0.45)	0.54 (0.58)	0.50 (0.55)	1.00

CORRELATIONS BETWEEN EMERGING MARKETS AND THE S&P 500[1]
(December 1975 to December 1986)

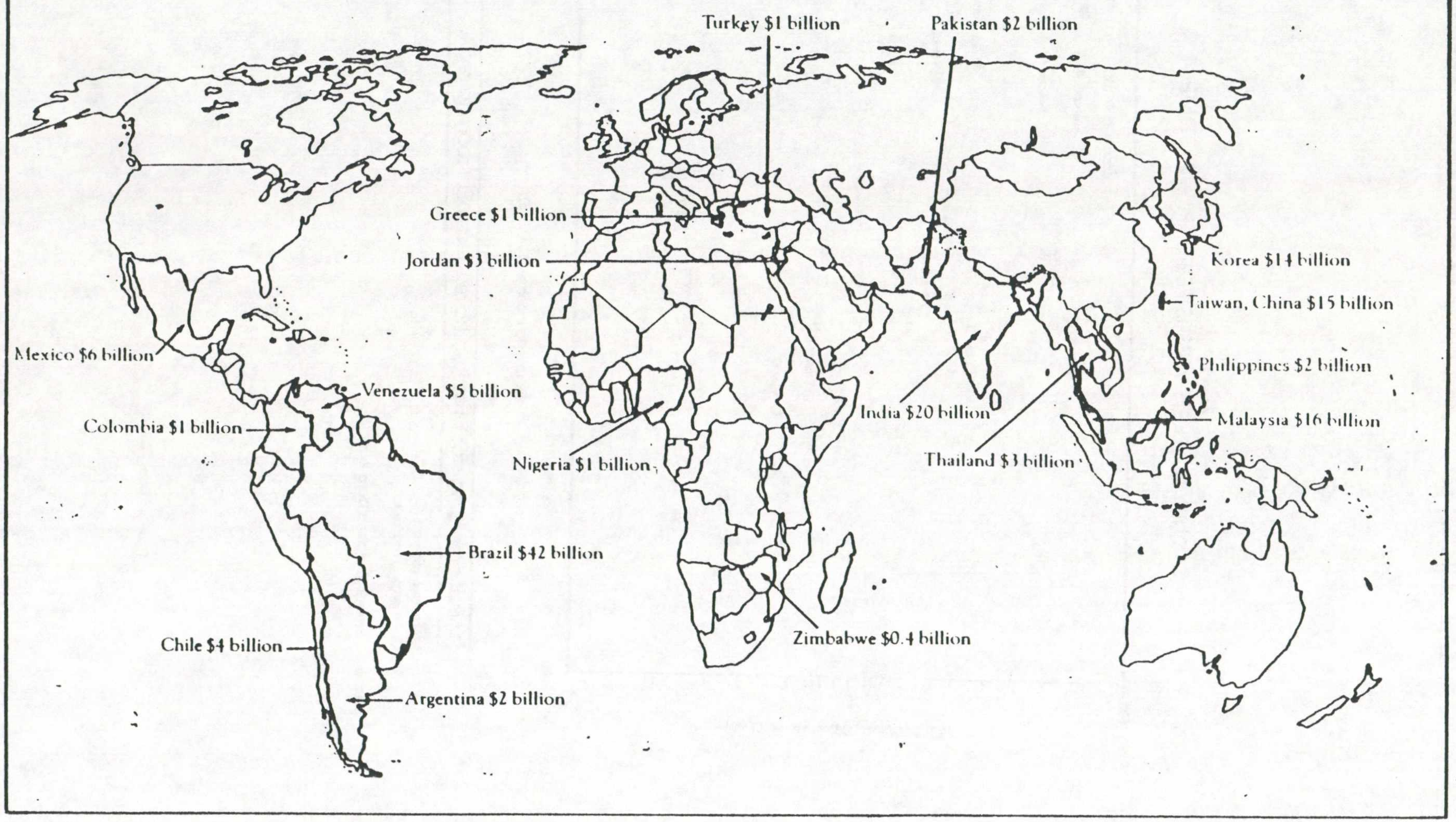


Emerging markets offer substantial opportunities for portfolio diversification.

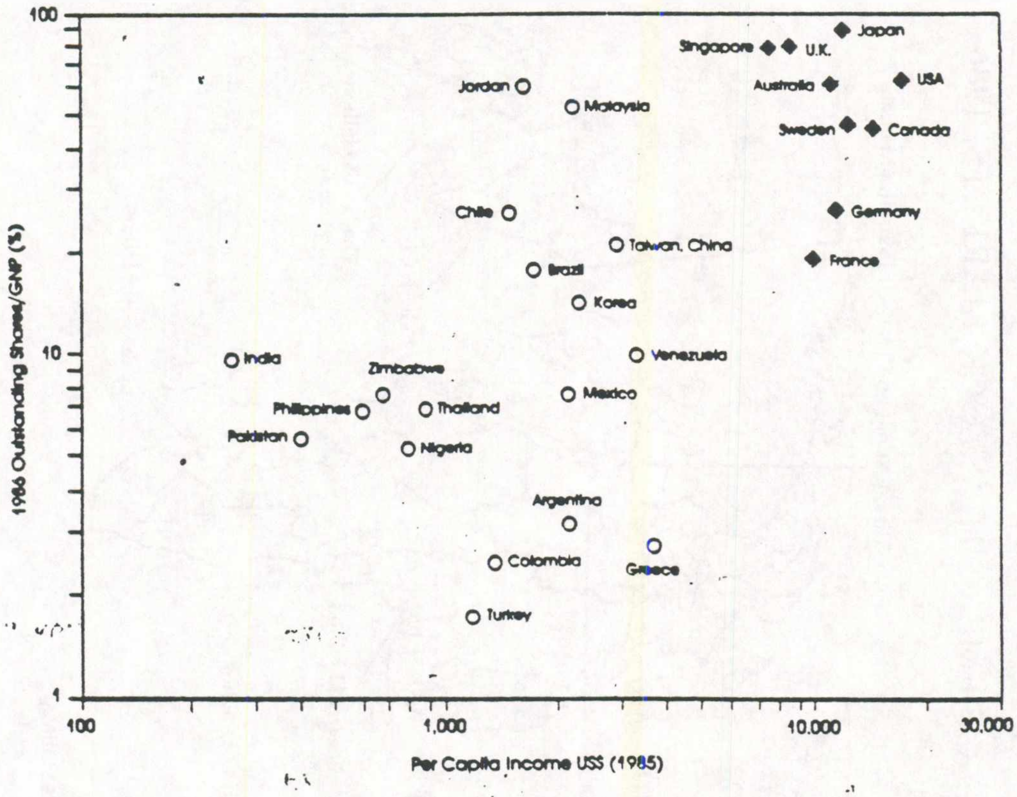
1. Correlations are between the IFC's price indexes and the S&P 500 (without dividends) on a monthly basis.
2. The Amman Financial Market began operations in 1978; the correlation covers 1978-1986

Source: IFC Emerging Markets Data Base

THE WORLD OF EMERGING STOCK MARKETS, 1986



EQUITY MARKETS VERSUS PER CAPITA INCOME



Most emerging stock markets have substantial room to grow.

◆ Mature markets
O Emerging markets

Source: IFC Emerging Markets Data Base

RETURNS AND CORRELATION COEFFICIENTS FOR SOME EMERGING STOCK MARKETS

Stock Market	1977	1979	1981	1983	1985	1987 Q_1	1987 Q_2	1987 Q_3	Correlation with USStock Market /a
					(December 1975 = 100)				
Argentina	130	862	351	183	134	152	141	142	-0.37
Brazil	114	102	95	101	265	115	109	128	0.06
Chile	473	1706	1716	668	658	1897	1997	3358	-0.06
Mexico	99	442	340	163	289	908	1422	2445	0.00
India	152	279	490	500	967	840	749	733	0.88
South Korea	370	398	438	453	624	1422	1551	1614	0.61
Thailand	289	245	174	231	183	341	407	594	-0.41
Greece	135	127	82	58	61	144	152	366	-0.76
Japan	144	193	287	329	548	1307	1404	1465	
U.S.	114	144	182	271	379	545	572	610	
World/b	117	156	193	264	396	634	735	781	

/a As measured by the Standard & Poor 500 index
/b The Morgan Stanley World Index

SOURCE: The International Finance Corporation Emerging Market Index.

JAPANESE DIRECT INVESTMENT TO GREECE
- PRESENT SITUATION AND FUTURE PROSPECTS

Minoru Tsuyuki
Director
The Bank of Tokyo Ltd

**JAPANESE DIRECT INVESTMENT TO GREECE -
PRESENT SITUATION AND FUTURE PROSPECTS**

Minoru Tsuyuki
Director
The Bank of Tokyo Ltd

Thank you Chairman,
Good morning Ladies and Gentlemen,

Some years ago while I was resident in London as an international banker with responsibility for Greece, I visited Athens on a number of occasions and always came away impressed by the long history of the country, its beautiful scenery and its potential for economic expansion. I am delighted to be back in Athens after an absence of five years and I feel extremely honoured to have been given the opportunity to address this Euromoney seminar on the theme of "Greece in the World Economic Community".

Greece and Japan, positioned on the eastern edges of the European and Asian economic blocs, are separated by 9,000 km but the two countries have a number of interesting points in common - a long history spanning thousands of years, a single language, a practically uniform religious environment. Although Japan has three times the land area and 10 times the population, there are certain similarities, for instance, both countries are surrounded by sea and have for some long period of time enjoyed strong shipping-related industries. However, it must be admitted that economic relations between Greece and Japan, including direct investment, have not been very deep.

Today I should like to give an outline of the current level of Japan's direct investment to Greece and its future prospects, looking especially at ways of promoting the tourist industry, on which high hopes have been placed for the future.

The level of overseas investment by Japanese companies, based for the sake of simplicity on data on the number of firms, is as shown on Slide 1.

From the beginning of the 1980s, there was an acceleration in the rate of overseas investment by Japanese firms. However, it is clear that the majority of these investments have been made in the US and Asia. At present over 48% of Japanese listed companies have direct investments overseas, which is a startling increase on the 39% of 10 years ago.

There are a number of different motives for Japanese manufacturing industry to invest overseas but they can be divided broadly into two categories [Slide 2]: first, the securing of markets, and second, the pursuit of cost advantages.

The first type of investment is typically targeted at the United States. For the Japanese automobile industry, the US represents the largest export market for finished vehicles, but now the industry is seeking to ease trade friction and secure the market by switching to US-based production.

Honda, Nissan and Mazda have already started production, while Toyota is producing through its joint venture with General Motors, NUMMI, and will begin independent production this year.

Mitsubishi Motors aims to start production in 1988 through a joint venture with Chrysler, while the joint venture between Fuji Heavy Industries and Isuzu Motors is to start production in 1989. The major automobile manufacturers, then, are one after another going into US production, trying to secure their US markets.

On the other hand, the target countries for investor firms motivated by cost advantages are first and foremost the NICs and other Asian countries. A great number of listed and unlisted Japanese firms are interested in this type of overseas investment. The goods manufactured are either exported directly to a third country or brought back to Japan. Either way, from the point of view of expanding their export industries, these investments bring about significant benefits to the host country.

While the number of companies that have invested in the EC to date is comparatively small, the motivation of these Japanese companies has been principally of the first type, to secure market share. We can particularly expect an increasing number of direct investments into the EC by Japanese manufacturers of products that unfortunately are affected by the frequent dumping disputes brought before the EC Council. These include manufacturers of microwave ovens, CD players, VTRs, electronic typewriters, electronic scales and mini ball bearings and the manufacturers of components for such products. For investments in the EC countries there is a considerable divergence in the choice of country, region or district, according to whether the investor firm's primary consideration is market access or manufacturing cost, and it can depend on the nature of the product itself.

Let us now look at the present state of Japanese direct investment in Greece, which is still rather limited in scope [Slide 3]. To date 16 such investments have been made, with a reported value of US$93m. Only four of these investments were made by manufacturers.

These are Hellenic Steel Co, a joint venture of C Itoh, Nippon Kohan and local partners in Greece; Tekkosha Hellas, a joint venture between Tosoh Corporation and Mitsubishi Corporation; Hitachi-Carnal Hellas, a subsidiary of Hitachi Limited that assembles TVs, and Yoshida Hellas, a subsidiary company of the zipper-producing YKK Group. In addition, although it does not represent a Japanese direct investment, Theocar has entered into a technical agreement with Nissan Motor and has begun manufacture of 14,000 vehicles a year under licence.

Compared with this situation in Greece, Japanese firms have set up 68 production facilities in Britain, 53 in West Germany, 38 in France, 33 in

Spain, 19 in the Netherlands and 12 in Ireland. Direct investment by Japanese firms in Greece, therefore, is still in its very early stages.

Indeed certain surveys attribute Japan's delay in investing in Greece to reasons such as:

- The level of development of the infrastructure and supporting industry has not been satisfactory.

- There are only a small number of Greek companies in a position to become joint venture partners.

- The weakness of the drachma.

- The complexity of government regulations.

- The rigid application of labour laws.

However, other countries that I mentioned before, for example Spain and Ireland, succeeded in inviting those numbers of Japanese direct investment after a long period of marketing efforts.

Let us now consider how direct investment in Greece may be encouraged in the future.

The advantages felt by a potential direct investor to Greece may be summarised as follows [Slide 4]:

1 Relatively low labour costs and high productivity.

2 Greece's membership in the EC, which has taken on special significance with the broader application of an anti-dumping tax beginning in June 1987 and the planned integration of the market by 1992.

3 The improvement in Greece's investment environment since July 1986 due to capital transfer liberalisation measures and the revision of investment incentive laws.

4 The success of Greek government policies since October 1985 to stabilise the economy.

5 The geographical location of Greece, particularly its proximity to Europe, the Middle East and the North African countries, is an advantage to exporters.

Among its investment incentives, the Greek government offers subsidies. These incentives are in fact quite attractive in comparison with those offered by Britain and West Germany, where most Japanese direct investments in the EC are located.

For example, in Britain the regional development grants previously provided automatically were abolished as of April 1988. This leaves only the regional selective assistance scheme, for which investors are eligible if the investment is made in one of the specified regions. The level of assistance is decided on the basis of individual negotiations between the British government and the investor firm.

In West Germany, when production facilities are established in government-designated economic development regions, the investor can receive a tax-free subsidy of 8.75% to 10% of the value of the investment after deducting the land purchase cost.

In contrast to this situation, in Greece, investments made in certain government-designated industrial areas are entitled to subsidies of up to a maximum of 50% of the value of the investment.

At first sight, then, the investment incentives offered by Greece are considerably higher than those of Britain and West Germany. However, a problem for the investor company is the complexity of the procedures and regulations, making the subsidy system difficult to comprehend and, thus, difficult to utilise.

Now I should like to talk about the future outlook.

Japanese firms likely to make direct investments in Greece may be expected to take one of two courses: either they will set up manufacturing facilities to take advantage of the favourable Greek investment environment or they will invest in the tourist industry, constructing hotels and resorts.

One of the most important considerations for Japanese manufacturing industry when contemplating a direct investment in Greece, or in any of the EC member countries, is the degree of ease with which they can procure parts in the host country. In this case, and in relation to dumping regulations, household appliances and communications equipment appear as hopeful areas, as also textiles, especially cotton goods.

The tourist industry, especially, presents excellent opportunities for direct investment, exploiting the image of the Aegean Sea and Greece's historical sights. I shall look in greater detail at this topic later in my presentation.

In order to promote direct investment from overseas I believe that Greece must, first of all, simplify the regulations concerning investment incentives and, secondly, establish more concrete and positive measures to that end.

On the second part, one idea would be the establishment in Greece of an organisation such as an Industry Development Corporation (IDC). The IDC would carry out PR activities to promote direct investment from overseas, act as a clearing house for direct investments and set up and provide a variety of incentives.

A number of IDC-like bodies are already succeeding in other countries, among them the Thai Board of Investment and the Malaysian Industrial Development Authority. Several advantages of setting up such a body stand out:

1 A combined liaison office and information centre would result in less work for the investor company and make it easier to obtain the necessary information.

2 It would be easier to build up an effective investment promotion policy.

3 The mere establishment of an IDC has a positive PR effect in portraying the host country as forward-looking in relation to direct investment.

As one further proposal to promote investment, I should like to recommend the establishment of an agent in Japan to serve as a liaison for direct investment in Greece by Japanese firms. Such an agent would be able to maintain a wide range of contacts with Japanese companies, supply the relevant necessary information to firms considering an investment and actively publicise Greece among potential Japanese investors. Such an agent could be a key ingredient in the effective promotion of Japanese direct investment in Greece.

Lastly I should like to speak about the development potential of tourism in Greece and the possibility of Japanese direct investment in this area. I hardly need mention that Greece, with its history, its architectural remains and its natural beauty, has great potential for attracting tourism from Japan, in spite of the long geographical distance separating the two countries.

[Slide 5] At present, however, comparatively few Japanese have been fortunate enough to experience the wonders of Greece by themselves. In 1986 Greece was visited by 7m tourists from overseas, the Japanese accounting for only 1.2% of the total.

[Slide 6] In 1986 a total of 5.8m Japanese travelled abroad but of this figure only some 86,000, or 1.5%, visited Greece. However, this figure looks much better if we consider the proportion amongst Japanese visitors to Europe who chose Greece as their destination. In this case the percentage in 1986 was 14.2%.

Over the past few years there has been a remarkable increase in the number of Japanese travelling abroad, due mainly to the appreciation of the yen and the greater opening of Japan towards the outside world. From 1983 to 1986, Japanese tourism has grown at the rate of 10.4% annually. The yen is expected to remain strong for the immediate future and, judging by the present state of the Japanese economy and the attitude of its people, this trend in tourism is likely to continue for some time to come.

Taking a look at Greece again, the number of Japanese tourists visiting Greece has increased only slightly, from 82,000 in 1983 to 86,000 in 1986. Why is this? There are two factors which have prevented Japanese tourism to Greece from expanding any further: first, the problem of air transportation and, secondly, the question of accommodation for Japanese tourists in Greece.

Looking first at air travel there are at present only two direct flights per week from Japan to Greece. Moreover airlines such as Lufthansa and Swissair, which used to fly from Tokyo to Europe via South East Asia, are tending to increase direct flights to Europe and discontinue the southern route. This has made Greece even less accessible since it is necessary to transit at major European cities in order to get to Athens. Some solution should be strongly pursued by the responsible authorities.

Turning now to the question of accommodation, the two issues involved here are those of quantity and quality. Greece has 3,800 hotels with a total of 157,000 rooms and 297,000 beds.

In terms of quantity, the hotel industry in Greece compares in scale with its counterpart in Yugoslavia but is only about one-third the size of that of Spain. There is no question that if we take into account its tremendous tourist potential Greece suffers from a shortage of hotel accommodation.

Greek hotels are classified in six levels, from luxury through classes A, B, C, D and E. Japanese tourists tend to do a great deal of sightseeing in a short period of time. Therefore they favour, and can afford, short stays in luxury class hotels. Greece has only 45 hotels in this class, such as the Holiday Inn, Hilton, Marriott and Intercontinental, with a total of only 10,000 rooms. Even if we include class A hotels Greece has only 255 hotels falling in these two categories, with 46,000 rooms. Thus the supply of hotel accommodation seems hardly adequate to meet the needs of extensive Japanese tourism if we seriously promote it.

Talking about quality specifically in relation to Japanese tourists, hotels are also expected to make allowances in terms of facilities. In Hawaii and California, for example, which are visited by large numbers of Japanese, hotels try to make themselves attractive to Japanese tourists by installing restaurants serving Japanese food, employing Japanese-speaking staff or building golf courses nearby.

Just to illustrate the economic impact of Japanese tourism on Greco-Japanese trade relationships I will quote some figures.

The Japan Travel Bureau estimates that hotel-related spending by Japanese tourists brings into the countries they visit an average of US$300 per person in foreign exchange. If we include personal spending and purchases, this figure rises to US$450 to US$500 per person. For an increase of 100,000 tourists, we could expect an annual increase in foreign exchange income to Greece of close to US$50m, a significant figure when compared with the US$30m annual value of Greece's top export to Japan, tobacco leaves.

The Japanese government is now undertaking what it calls a "ten million programme" which aims to double the number of people travelling abroad as a means of redistributing the current account surplus. It includes various promotion measures such as advertising campaigns, tax incentives, promotion of longer vacations, facilitation of air transportation and so forth. This government policy promoting overseas travel, added to the strong yen, the favourable state of the economy and the trend towards a shorter working week, is likely to result in even greater numbers of Japanese travelling overseas in the future.

Along with this trend, the Japanese tourist and travel industries are increasing their overseas tourist investments. A majority of these investments has so far been targeted to locations that have traditionally attracted most Japanese tourists, such as Hawaii, California, Australia and so on.

In view of the ever-growing awareness of Japanese tourists of the interest and attraction presented by a country like Greece as compared with the above-mentioned locations, the current Japanese tourism is bound to increase and, once tourism from Japan begins to pick up, the Japanese travel industry and other related industries are bound to take advantage of the situation and increase their investment in Greece. So, solutions must be found to the problems we have discussed, in a joint effort of both public and private sectors, which will certainly result in a sustained increase in the flow of Japanese capital to Greece in the form of tourist investment.

To conclude, as we have seen, although Japanese direct investment in Greece is still in its initial stages, it has considerable latent potential. Japanese financial institutions have had a long relationship with Greece in arranging and advising on funding needs. We hope to continue to cooperate in the future to forge even closer economic links between Greece and Japan and, in particular, promote Japanese direct investment in Greece.

Geographical Distribution of Japanese Direct Investment

	Before 1970	1970'S	1980'S	Present Balance
U.S.	300	750	1,150	2,200
NICS	280	1,000	720	2,000
ASIA (other than NICS)	200	600	500	1,300
EUROPE	130	600	870	1,600
OTHERS	190	950	760	1,900
TOTAL	1,100	3,900	4,000	9,000

* number of companies
* includes joint ventures

Motives for Japanese Manufacturing Companies' Overseas Investment

1. **Securing Markets**

   U.S.A.

   Europe

2. **Pursuit of Cost Advantages**

   NICS

   Asia

Number of Manufacturing Operations of Japanese Companies in E.C.

U.K.	68
F.R. GERMANY	53
FRANCE	38
SPAIN	33
NETHERLAND	19
IRELAND	12
GREECE	4

Advantages of Greece as a Location for Direct Investment

1. Low labor costs and high labor productivity
2. Membership in the European Community
3. A better investment environment created after 1986
4. Strong economy
5. Strategic location

Number of Tourists to Greece

	1983	1984	1985	1986
TOTAL	4,778	5,523	6,574	7,024
(Increase %)	(△5.1)	(15.6)	(19.0)	(6.9)
JAPANESE	82	86	92	86
(Increase %)	(9.3)	(4.9)	(7.0)	(△6.5)
JAPANESE/ TOTAL (%)	1.7	1.6	1.4	1.2

Number of Japanese Tourists to Overseas

(Thousand)

	1983	1984	1985	1986
North America	1,521	1,680	1,745	2,043
Europe	447	502	543	604
Asia	2,121	2,311	2,420	2,829
Total	4,310	4,745	4,980	5,802
Greece (%)	1.9	1.8	1.8	1.5

KEYNOTE ADDRESS

Andreas Papandreou
Prime Minister

ADDRESS BY THE PRIME MINISTER, MR.ANDREAS PAPANDREOU, AT THE EUROMONEY CONFERENCE ON APRIL 20, 1988

Mr.Chairman,

Ladies and gentlemen,

The autumn of 1987 filled us with the greatest fears for the future of the world economy. The stock market crash of last October threatened to plunge the world into a repetition of the catastrophic depression of 1930. It was followed by the winter, and the December crisis in relations among the European Community partners when they failed to agree in Copenhagen to the Delors package and resolve such a simple matter as the Community budget.

On the other hand, the spring of 1988 finds us in a much better position. The fears of a great drop in world production and in employment do not seem, fortunately, to have been borne out so far. The European Community, on its side, has managed to overcome the disagreements among its partners. The crisis, which for a moment seemed to have jeopardized the very basis of the European idea, was resolved by the Brussels agreement in March. Present circumstances in the world and in Europe allow us to look to the future with greater confidence.

This does not mean that the basic problems which created the crises of last autumn and winter have been solved as if by magic.

The spring sun has broken through the winter clouds but has not dispersed them. One of the structural problems which persist are the lack of balance between the great economic centres of our time. I consider these centres to be five: the United States, Western Europe, the Soviet Union with Eastern Europe, Japan and the Third World.

The relations among these five centres are characterized by rivalries of varying degree and quality. Today, I shall not be dealing with the overall problem of the world balance of power. I shall ask you to pay attention to that part of the picture which affects us more immediately: the triangle formed by the United States, Western Europe and Japan. In this area, despite the political and military alliance among its members, economic rivalries have not disappeared. On the contrary, if we look at the longterm perspective in time, we shall have to admit that these rivalries are increasing.

At the end of World War II, when the Western Alliance was formed, there was no question of rivalry among its partners. The United States were so crushingly superior in military and economic terms that their leadership was taken for granted.

Gradually, however, up to a degree -- objectvity obliges me to say this -- and thanks to the generous aid of the United States towards one of its devastated allies, Western Europe, and towards two of its devastated enemies, Germany and Japan, new centres of power were created in the western world.

One of them was homogenuous in terms of culture, nationality and statehood. I mean, of course, Japan. As for Western Europe, although it does not have a similar homogeneity, it was obliged under the pressure of modern economic developments, to seek the road towards unification. Thus, the objective circumstances were created for a challenge to American dominance immediately after World War II.

I believe that many of the commercial and currency crises we have lived through and are living through,including the dollar crisis, ultimately go back to this crisis of leadership in the western world.

I am not sure that the crisis, the one which objectively still exists, can be subjectively expressed with a specific claim to the mantle of the former American leadership by one of the other two centres. More likely, what is happening is the progressive independence of Europe and Japan without either of them showing the desire or the ability to restore the old unity under its own domination.

Unity, however, is necessary. It is imposed by developments in the means of production, transport and telecommunications. It is imposed also by the fact that the spectacular, postwar economic development of the western world was based, to a great degree, on the rise in foreign trade which gradually bound the various countries into a singularly dynamic economic whole.

This situation in which there is a need for unity in conditions where there is no dominance, is a dangerous one. But it also contains a historic opportunity to try something completely new and original in international economic relations. To restore unity in our economic area with procedures for cooperation, without the imperial decrees of a leading power. This is the great, historic challenge that faces us today.

The European Community is perhaps the international centre best-prepared to meet this challenge. From the first moment of its establishment, the Community had to deal with the problem that faces the whole western world today: how to join together various countries in a supra-national unity when there is no single country strong enough to impose itself on the others.

The solution that Europe has tried to give to the problem is contained both in the Treaty of Rome of 1957 and in the practice of inter-Communal negotiations in the years that followed.

The main principles on which the entire European effort was based are two. One was a formal principle: the emphasis on procedures of common consent, a formal guarantee for the smaller partners in particular, that no unilateral decisions would be taken at the expense of anyone. And a principle of substance: that at each stage of the unification procedure, each member-country would have some economic gain.

This was the course charted by the Treaty of Rome and which has always been followed by the organs of the Community. We should, of course, note that the actual working of the Treaty was not always in accordance with the ideal. As I have pointed out in the past (interview with the newspaper TO VIMA on January 1, 1988), there was a directorate within the Community composed of the larger member-countries, which looked upon Europe as its own bailiwick.

In other words, they wanted to have a large, protected market in which they would be certain to sell their products. However, they had to give something to the other partners in exchange.

What was it? It was the redistribution measures adopted by the Community, using the structural funds such as the Regional Fund, the Communal Fund and, to a degree, the Agricultural Fund in order to transfer certain funds from the wealthy to the less wealthy partners. The object of the transfer was to counteract the tendency of free competition in a common market to make underdeveloped regions marginal.

These institutions for redistribution in the European Community have gained in importance in recent years, following the accession of countries such as Greece, Spain and Portugal -- countries which would be in danger of being pushed aside and overwhelmed by competition from their larger partners.

The Community's redistribution machinery was not automatic. Hard battles had to be fought to make it work and Greece led the fight right up to the end. Thus we succeeded in bringing about the Integrated Mediterranean Programmes which became a means of support for Europe's south.

Thus we succeeded, in coopertion of course with other interested countries at the last Summit Meeting in Brussels, in more or less doubling, up to 1992, the resources of the structural funds. We must not overlook the fact that the final agreement at Brussels, which opened the way for an integrated market in 1992, was made possible only in combination with the adoption of measures of social solidarity. Measures to protect the lesser developed member-countries from the unavoidable shocks of the reconstitution of economic activity in an integrated European area.

The conclusion to be drawn, I think, is that the unification of Europe has been based so far on two principles which seem opposite but which complement each other. The principle of free trade and the principle of communal -- which is merely another form of social -- solidarity. The relative procedures were neither absolutely sufficient nor were they, in practice, completely devoid of elements of domination by the more powerful. But they came as close as possible to a system whereby rivalry or domination were moderated by institutions of solidarity and by procedures of common consent. Without these moderating factors, the course towards European integration would have been halted long ago. Greece, supporting the policy of communal solidarity, has made an important contribution to the cause of European unity.

Are the conditions ripe, today, for the European model to be extended to the whole western world so that the problem we described earlier could be solved? In other words, can economic unification proceed without subjection to a dominating power?

If we look to the letter of the Treaty of Rome and to European institutions as they have developed, the answer would probably be negative. It is too soon to envision a Commission that would include Americans and Japanese and would lay down the rules for the entire economic area of the West. If, however, we look to the spirit of European unification, the picture is a different one. We can more easily envision the three great centres of western economic life -- the United States, Western Europe and Japan, seeking a political consensus with the object of economic cooperation to the common benefit of all.

The form of cooperation is dictated, I think, by the nature of the problems we are facing. At this moment, the exchange of goods and services in the world is in danger of collapsing. The western world is in danger of being split into three, rival commercial zones under the pressure of a lack of balance in world trade. The United States are having to cope with a tremendous deficit in their balance of external payments which is leading to a systematic devaluation of the dollar, particularly in relation to the mark and the yen.

The devaluation of the dollar is displacing European goods from the international market.

It is boosting the tendencies for economic stagnation in Europe. On the other hand, it is contributing towards an increase in exports and reducing somewhat the trade deficit of the United States.

For some, the devaluation of the dollar could become the main weapon of American trade strategy, capable of restoring the United States's foreign trade and throwing the burden of readjustment on to the Europeans and the Japanese. Those who support this solution talk of a 15-20% devaluation of the dollar in 1988. It is the aggressive, domineering use of a strong currency at the service of a powerful country.

It is, however, outside the framework of the spirit of cooperation which should guide our actions. Moreover, I very much doubt whether the proposed method could be effective. It contains tremendous dangers. We should not overlook the fact that the United States's trade deficit and budget deficit are being funded by the savings of the entire world. To these private savings we should add the mass purchases of dollars by central banks during the past year.

The deposits made by foreigners in the United States produce a dollar income. Nobody likes to see his income reduced by a currency devaluation. More so the foreign capitalists who bought the dollar high when they made their deposits in the United States and do not wish to see the value of their capital reduced. If they become convinced that the devaluation of the dollar will cause them to lose more than they earn from their American income and if, even worse, these fears become contagious, causing a panic flight from the dollar, the American banking system will be obliged to raise interest rates despite the consequences on production and employment. The depression which will follow will, of course, wipe out the trade deficit by drastically reducing imports. The balance in world trade will be restored to a certain level but the cure will be worse than the disease. The drop of imports into the USA will transmit the depression to the rest of the world and we shall see the fulfilment of the danger we managed to avoid in October 1987. These are the reasons that make me believe that the devaluation of the dollar is not a valid solution.

Neither Europe, nor Japan have any interest in pushing the United States towards the impasse we have described. They have, on the contrary, every interest in coming to an understanding with the United States and help it wipe out its external trade deficit without an economic crisis. The means by which such a result can be achieved is nothing less than stimulating economic activity in Japan and in Europe. It is in the interest of the United States, also, to help the world move in the right direction. The means at their own disposal is to reduce their public debt which is absorbing so much capital from the rest of the world and it is creating the fear, if not the reality, of inflation in the event that Europe or Japan attempt a more decisive reheating of their economies.

An agreement by the United States, Europe and Japan to coordinate public debt and economic policies would be a European-style solution applied on a world scale. A solution without a dominant character since each of the three centres would be obliged to relinquish some of its authority in setting economic policy within the framework of the common agreement. A solution which would stimulate world trade just as the Common