

GREECE

*by Adam Lou*

In Greece domestic demand has continued to be sustained, in 1985, by the still vigorous expansion of public expenditure and by a further increase in the number of tourists. However, the positive contribution of the real balance of external trade has been sharply diminished by the combined effects of a marked slowdown in the rate of growth of exports (exceptionally high in 1984) and an appreciable upturn in imports. The growth rate for 1985 is thus likely to fall back to around 2%. Moreover, major disequilibria have continued to affect the economy. The rise in consumer prices has slowed down only temporarily and will remain, as an annual average, at around 18%. Business investment has continued at a very low level, showing no tendency to recover. Lastly, the sharp increase in the tourism surplus was not sufficient to offset the deterioration in other current account items; the deficit on current account (on Bank of Greece definitions) could be as more than 7,5% of gross domestic product.

The economy has therefore not yet embarked on the adjustments which are necessary for the recovery of growth on a sounder basis. One particularly disturbing factor is that external indebtedness is continuing to increase rapidly, whereas the share of business investment in domestic uses of resources is declining steadily. The economy is tending to become trapped in a vicious circle, so that it is liable to become increasingly difficult to restore external equilibrium as a result of inadequate investment to increase production capacity and to improve competitiveness. The priority aim of economic policy should therefore be to break this circle as soon as possible. This means not only gradually adjusting domestic demand as a whole to the external constraint, but also increasing as rapidly as possible the share of productive investment in domestic demand, in order to bring it to the level required to ensure growth in the future.



As a precondition for the attaining of this object, inflation must be mastered without delay, if investment and savings behaviour is to return to normal. The authorities should set themselves the target of bringing average yearly price rises down by at least a half from now to 1987. This aim evidently requires major efforts to contain the momentum of inflation, involving energetic action to curb the two essential factors which perpetuate it: spiralling costs, and the public deficit.

The first step should be to seek to obtain a very rapid moderation in the nominal increase in earnings, as compared with the rate of 20% or so still evident in 1985 and do not rule out, in so doing, reducing them somewhat in real terms. To bring sufficient pressure to bear on the trend of earnings, it is impossible to avoid appropriate changes in the operation of indexation, which, in its present form, has two disadvantages; it feeds automatically into costs, whether directly or indirectly, a large proportion of earlier price rises, and thus permits only very slow disinflation; and it renders wage-adjustment too independent of changes in productivity in the various sectors of the economy. A fundamental review of wages policy therefore seems essential for a rapid reduction in the pressure of costs and for a faster deceleration of prices, as well as for a start in the process of improving companies' financial situations, which have substantially deteriorated.

A start should also be made on reducing the public deficit, which, partly because of the insufficient yield from the tax system, will in 1985 again have overshot the very high level of previous years. The effort to be made should bring the general government borrowing requirement down to under 11% and the net balance to be financed in the central government budget down to about 10%. Given the vigorous momentum of interest charges and the need to maintain adequate investment in the public sector, these aims, over and above the



application of the strict salary norms mentioned above, will involve very rigorous management of administrative expenditure and a considerable reduction in the burden of subsidies. This reduction, among other things, will require an appropriate adjustment of public utility charges and other administered prices: to this end, an initial series of measures have already been taken. It will be equally necessary to go on increasing the pressure of taxation, not only, no doubt, by the reduction of evasion but also by the deliberate raising of tax-rates which seems to be unavoidable.

This two-pronged effort to reduce inflation should considerably reduce the pace at which the demand for credit increases; yet, monetary policy will still have to exercise restrictive action, intensifying the current rising trend of real interest rates, with a view to encouraging the development of a stable pattern of saving and, in particular, to extend the public placement of government securities which was started in 1985.

These measures should make it possible to point the economy more resolutely in the direction of sounder management which is essential for its subsequent recovery. It will nevertheless be necessary to supplement them by new measures designed to hasten the recovery of business investment, notably by making the prices policy more flexible.

As early as 1986, the policy described above, which should be maintained for at least two years, could begin to bear fruit. Domestic demand should begin to contract to the advantage of the external account but, on balance, it will not be possible to avoid a slowdown in growth, which will probably not exceed 1,5% on an annualized rate. Private investment should also pick up; this is likely to be reflected in a gradual climb in the investment share of domestic demand. The average annual increase in consumer prices could settle at around 16%, which would mean a much more pronounced slowdown in the rates recorded



during the year. Lastly, and due to the persistence of a favourable international environment, the balance of payments on current account, expressed as a percentage of gross domestic product, should start to recover.

This outlook does not hold out any hope of a rapid improvement in the employment situation; long-term recovery on this front will depend on the gradual strengthening of the upturn in investment and, consequently, on the maintenance of the policy of stringency by which it is primarily conditioned. This policy is, after all, the only one compatible with a cooperative strategy for growth at Community level.