PRELIMINARY

THE GREEK ECONOMY AND EUROPEAN INTEGRATION : PROSPECTS FOR DEVELOPMENT AND THREATS OF UNDERDEVELOPMENT

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A. Introduction

The Greek Economy finds itself at a critical juncture. Its recent history since the fall of the junta in 1974 is a history of repeated economic failures. If its performance over the last 18 years is projected into the next 18 years in a linear fashion, Greece will become separated by a huge gap from its European partners, and any notion of meaningful participation and deeper integration with the European economy will become entirely utopian. This indubitably pessimistic scenario suggests that Greece has no national model of European integration as yet, despite the fact that its participation in the EC and in the integration process has now entered its twelfth year. Some have argued that Greece has not yet solved its "problem of adjustment", meaning the lack of visible and permanent amelioration in the country's fiscal and external payment balances. I would say that these are symptoms of a problem which is more fundamental: Greece has not yet worked out those institutions, policies, productive arrangements and social behaviors which will harmonize, and place in a compatible track, European integration on one hand, and national economic development on the other. Under current conditions and present arrangements, the deepening of European integration spells continuous stagnation for the Greek economy. The emergence of a new set of institutions, productive structures, policy instruments, and ultimately of social behaviors is the key to Greek economic prospects within an integrated Europe and a competitive world economic order. The goal of this paper is to use the critique of past economic policies, historic performance, structural failures, and especially the current impasse, in order to substantiate the chief elements of fundamental reform which can overcome stagnation and produce reasonably stable growth.

The presentation and analysis of the paper will be organized around three basic propositions. First, that the problems of the Greek economy have to do as much with politics as with economics proper, since, I will argue, the emergence of a strong political-fiscal cycle in Greece is central to the interpretation of failures and the current impasse. Second, that the adjustment to international competition since entry of Greece into the EC has taken place in distorted ways which promote stagnation rather than development, by disorganizing the investment function within the economy. Third, that the coming wave of new international competition will be based on capital mobility, and that capital mobility will place a heavy requirement for new public initiatives and interventions in the economy.

B. A Brief Interpretative View of Greek Economic Performance

It is well known that the Greek economy was considered a "miracle" in the 1960s but is now considered an "anti-miracle", at least in comparative West European terms. This is evident in very simple quantitative terms, if we compare average growth rates and investment shares over the last three decades. Table I shows this comparison as well as the percentage of private and public investment expenditure into GDP, all in real terms.

TABLE I Here

It is evident from the data of Table I that the growth of Greek domestic product has suffered a chronic decline over the last thirty years, and that at the same time, the proportions of domestic product devoted respectively to public and private investment exhibit significant declines as well. This is not an unexpected phenomenon since it is known from wide international

experience that economic growth and investment rates correlate positively. It should be pointed out that in terms of comparative performance to the 11 countries which are present day partners of Greece in the EC, Greece's economic growth rate was 2.8 percentage points higher than its partners in the 1960s (hence the notion of "miracle"), 1.8 percentage points higher in the 1970s, but 0.7 percentage points lower in the 1980s [f]. It is commonly stated that the chronic decline of Greek economic growth reflects the exhaustion of the country's postwar "development model" and the inability to adjust to new realities. It is worth pointing out, that despite the faults and criticisms which can be levelled at earlier growth policies of the 1950s and 1960s, Greece did undergo successful adjustment in that period, and this took place in an international environment which had changed radically in comparison to the prewar order. It can of course be argued that the adjustment of the 1950s and 1960s was facilitated by large infusions of foreign resource transfers; yet foreign transfers are not a sufficient condition: it is well known that almost commensurate infusions of EC transfers took place in the 1980s, but did not manage to initiate sustainable and credible adjustments in the Greek economy [f]. Clearly then, the decline in economic performance cannot be simply laid at the doorstep of "foreign factors". It must be interpreted mainly in terms of domestic problems, or at best in terms of domestic capabilities to turn international challenges into opportunities for domestic reform and structural change.

No summary view of Greek economic performance can be offered without reference to the two deficits which are at the center of present day discussions of the economy: the current account deficit of external payments and the fiscal deficit of government payments. In Table II are shown summary figures for these two deficits as percentages of gross domestic product.

TABLE II here

The basic picture conveyed by the data of Table II is that both deficits grow considerably in the 1980s, as compared to the 1970s. In addition, whereas the deficit of external payments appears to stabilize, the fiscal deficit exhibits clear signs of upward destabilization. Although most current discussions and policy measures relate to these two deficits and to their amelioration, the long view which combines the findings in Table I and those in Table II suggests very strongly that the parallel deteriorations observed are not unrelated. The tendency of the economy to stagnate, and the drop of the participation of investment into national product are occurences which are very related to the destabilization of the external and especially the fiscal balance of the economy. Those who believe that policies are at the root of all good and evil, propound that the logical flow of influences goes from the imbalances of Table II to the stagnations of Table I, and that in addition it has been the choice of bad policies which has caused the imbalances of Table II to appear. I will state that I only partially share the premises of such a view at this point, hoping that the remainder of the paper will elucidate my own approach more clearly. It will suffice to say at this point however, that the order of presentation of the two Tables is not random but is rather chosen expressly to carry the suggestion that another possibility for a framework of interpretation is open: The Greek economy has been presented with a series of exogenous shocks since the early 1970s. Oil shocks, military expenditures, EC entry and relatively abrupt decline of domestic manufacturing. These shocks naturally created pressing problems both in the country's external payments balance and in internal social conditions. Consequences of

different persuasions formulated and implemented a variety of policies in response to these shocks; but these policies were basically policies which sought to insure incomes, or in general to regulate incomes in conditions of crisis [f]. This meant that public deficits would inevitably grow, but that the policies causing them were not necessarily conducive to economic growth. As a result, the primary impact of exogenous shocks which was stagnationist persisted, and this led also to maintainance or even expansion of the problem of deficits.

This alternative story which I offer as a credible suggestion has three advantages over the more simplistic story of exclusive responsibility of bad policies. First, it conveys the view that policies respond to social pressure and social perceptions, via the political mechanism. They are not, in other words, simply conceived by inept or self-interested politicians who defy all technocratic wisdom for selfish reasons. Thus, the not unhealthy primary response of a society to seek guarantees of its income and its living standard when faced with external crisis in the short-term, becomes an important determinant of policies which seek to accomodate this response. Indeed, I would argue that the economic expasnsion of the public sector which has been so observable since the late 1970s was to a large extent a response to crisis rather than a conscious strategy of growth. Its inherent problem however, was that it converted a necessary short-term response to long-term policy. Secondly, the alternative story furnishes a more plausible "internal" explanation of policy cycles. That is, when expansionary responses take the form of additional income formation, the increase of inflation, the deterioration of external balance and/or the worsening of fiscal conditions, cause what I have elsewhere called a "pang of conscience" phenomenon [f]. This means that policy-makers think they have gone too far and must reverse their previous actions. Policies of austerity emerge at that point, and their focus is naturally the neutralization of previous

expansions of incomes. The ideological conceptions which come to predominate at that specific juncture are organized around the supposed ability of income restraints to settle all the problems of society and to fire up the growth process. Greek experience so far has not confirmed this view. Yet, Greek policy-makers seem magnetized by the simplicity and the promise of this view, and consequently appear to insist on it as the basic organizing principle of economic policy. Thirdly, the alternative story has the advantage that it at least allows us to focus on what might be causes rather than symptoms of Greek economic problems, that is the investment mechanisms of society and the machinery of economic growth. For many years it has been a constant puzzle to me how, in the face of stagnation and disinvestment, most policy discussions focus on subjects other than growth and investment in Greece. Yet, this is the outcome of a strange but persistent fascination with income-related measures and instruments of policy. If one observes carefully the content of macro-economic policies, including fiscal, monetary and exchange rate policies over the last 15 years, it is easy to see that their basic instrumentality and most frequent outcome was the formation or the restriction of incomes. Even policies which purportedly were designed for the promotion of investment, became quickly subverted into policies of income formation, since investment incentives became the objective of autonomous income-maximizing actions on the part of a variety of economic agents [f].

C. The Charm and the Curse of Political-Fiscal Cycles

Greek politics has always had a strong element of clientelism but clientelism can take many forms and not all of these are conducive to the appearance of political-fiscal cycles. Thus, for example, one of the chief manifestations of traditional clientelist politics in Greece has been the offer of public sector jobs to partisan clients. This has undoubtedly contributed

to the formation of a bloated public sector but not necessarily to observable time patterns of political-fiscal cycles. The hiring of public-sector employees, especially if it is decentralized in a variety of agencies, organizations or firms, may be smoothed over time. It may occur in addition, not only as an inducement before elections but as a reward after elections, thus becoming again more distributed in time. On the other hand, the regularity of election times, e.g. the conduct of elections every four years rather than at irregular intervals, is conducive to the appearance of political-fiscal cycles since it encourages the concentration in time of electorally motivated favors, grants, income concessions and the like. In the actual case of Greece, the late 1970s witnessed the rise of a virtually bi-parisan political system and the 1980s witnessed two changeovers of power between the two major parties, through regular elections of uncontested honesty and constitutional merit. These undoubted successes of political stability and effectiveness were accompanied by the emergence of the electoral-fiscal cycle in Greece. The welcome emergence of good politics and institutional stability has become marred by mediocre economics and the subversion of economic institutional stability, as a result. This assertion requires both empirical substantiation and additional explanation.

TABLE III here

In Table III are depicted the basic magnitudes of fiscal management in Greece over the period 1980-89. Total expenditure is netted against total receipts and the deficit is calculated as a percent of GNP. The two basic observations we can draw from the Table are as follows: First, there is a chronic tendency for the public deficit to increase and the increase

becomes explosive at the end of the decade. Second, within the general increasing trend, the three election years included in the period (1981, 1985, 1989) represent well defined peaks in the ratio of deficits to GNP [f]. This constitutes clear evidence of the occurence of an electoral-fiscal cycle at a very aggregated level of economic behavior. More specifically, the average deficit ratio over the ten years is 0.141. The average of seven non-election years is calculated at 0.121. The average of the three election years is calculated at 0.184. Thus, the election years' average deficit ratio exceeds the non-election years' average by over 50 percent. This sharp appearance of an electoral fiscal cycle presents two immediate implications. The first is that these cycles appear to become sharper overtime but also more asymmetric. That is, after each electoral burst in the deficit ratio, the rollback to a more normal deficit level is harder to bring about. Thus, the cycles cause spiralling behavior which is destabilizing in the longer term. This is easy to explain since after a few repetitions, electoral cycles themselves become part of society's expectations about the economy; even harsh austerity packages after the elections may not be able, for example, to reverse expectations about expansion of nominal incomes if interested agents come to believe that no austerity policy can withstand a full phase of the political cycle. As a result, austerity policies must become even harsher after each successive peak of the cycle to bring about a given result. In that sense, the cycle corrupts the effectiveness of economic policy.

The second immediate implication of the political-fiscal cycle is that it creates a strong alternation of demand stimulation and shrinkage which put the whole economy on a roller coaster of expansions/contractions. In Table IV we show an analysis of annual growth rates in the years 1980-90 by their time proximity to election years in that interval.

TABLE IV here

The calculations of Table IV show that the political-fiscal cycle does influence the growth pattern of the economy, even at very low levels of growth as those observed in the 1980s. Thus, its effects are generalized and penetrate all aspects of economic life in the country.

In terms of the institutional integrity of the public sector, the political-fiscal cycle has been highly corrosive. We can summarize here the conclusions of other research regarding three aspects of public sector institutional integrity. The first aspect is taxation. Evidence from the three elections in the 1980s indicates that tax elasticities systematically decline in election years [f]. This implies either laxity in tax enforcement or conscious lags in tax collection during election years, or finally it implies that taxpayers themselves comply less honestly in those years, having embodied expectations of lax enforcement in their calculations. It is obvious that in either case the moral fabric of tax compliance itself is damaged, and this happens in a country where tax morality has not been of so high a standard in any case. Besides the obvious implication for revenue shortfalls, this effect of the political cycle is to subvert the institutional integrity and the credibility of the tax system.

The second aspect is public investment. We have seen the overall downward trend in public investment, but more detailed readings of data indicate that during the sharp post-election retrenchments of public expenditure, that is in the downward phase of the cycle, public investment absorbs more of the shock of retrenchment than other expenditure categories. I have argued elsewhere that this is in part caused by the fact that whereas other categories of public expenditures have powerful social

groups of immediate beneficiaries to lobby for them. the beneficiaries of public investment who are members of future generations or potential future investors are in no position to form a powerful lobby [f]. It is also evident that public investment, if directed to durable projects with intertemporal continuity, could act as a stabilizer of both government behavior and of private expectations vis-a-vis the investment climate in general. Furthermore, the attractiveness of public investment's social returns is increased in a country suffering from a great shortage of infrastructures. Thus public investment, if it could be isolated from the political cycle, could operate as a tool for the transcendence of the political cycle. Instead, it has shed these very properties because it has been subjected to the vagaries of the cycle. Again, the integrity and the credibility of the investment function within the public sector have been damaged by the fiscal-political cycle, as a result.

The third aspect is public entreprise. Within a public sector undergoing political cycles, public entreprise can attain neither managerial autonomy nor economic rationality. On the contrary, during the upward phase of the cycle, public entreprise becomes, and this is supported by anecdotal but uncontested Greek evidence, a primary area for the discharge of various obligations to clients, such as hirings, privileged access to service, or special pricing. During the downward phase of the cycle, the previously accumulated deficits of public entreprise are used to rationalize economies which however mostly affect again their investment budgets, not unlike the similar mechanism which was described about public investment proper. Thus, the political cycle ends up as a factor which subverts managerial rationality but also the modernization of public entreprise and the provision of infrastructure for social services supplied by public entreprise. One last point is that the conditions produced by the political -fiscal cycle upon public entreprise legitimize calls for privatization,

as means of isolating them from the political cycle.

Clearly all three aspects -taxation, public investment, public entreprise- are adversely affected by the political-fiscal cycle, not only in terms of current performance and deficit creation but also and more importantly in terms of institutional damage. The reputation, the economic credibility and the ability of the Greek public sector to produce predictable and stable stimuli for economic growth and change are all placed in grave doubt by the political-fiscal cycle. In a longer-term view, these aspects of intangible capital (reputation, credibility etc.) which are heavily used up by the political-fiscal cycle may prove much more costly for society to overcome than the deficits themselves.

D. Modes of Adjustment to International Competition

It is important to focus on the last decade during which Greece entered the EC as full member, and exposed itself to the full force of international competition in trade. The general assertion of this paper that Greece has not managed to find ways which will make integration and development compatible is now taken up in terms of more particular arguments and propositions. The previous observations in Tables I, II, III showed that growth, inverstment, external balance and fiscal balance all deteriorated significantly during the 1980s. Was this deterioration an outcome of the shock of Greek entry into the EC? Or was it due to factors unrelated to the Community but related to domestic policies, for example? Although one hears arguments on both sides of this dilemma, it is in fact very difficult to decide this issue with proper methodological safeguards for a very simple reason: It is virtually impossible to construct a model of what the economy would be like, if ceteris paribus Greece had not become a full member of the Community [f]. Furthermore, although domestic policies did undergo a discrete change in 1981 due to the rise of Socialists to power, it is not

possible to argue that these domestic policy changes were unrelated to entry to the EC, since they were clearly influenced by this major institutional event for the Greek economy and society. Thus, it would be more appropriate to speak of a complex of events which embraced both the entry of Greece into the EC and the changeover of power in Athens as the "syndrome" under which the Greek economy had to fashion its adjustment from 1981 onwards.

The major institutional event - Greek entry into the EC - affected all spheres of economic life. Internationalization is a phenomenon encountered both in the sphere of consumption and in the sphere of production. In the case of Greece, most observation and research appear to suggest that the adjustment in the sphere of consumption has led the way, and that the adjustment in the sphere of production is not yet fully complete [f]. Addressing the sphere of consumption first, the important points which must be addressed are two.

First, EC entry meant a rapid jump in import penetration, especially in manufactured consumer products. In Table V are shown summary statistics of foreign trade and import penetration.

TABLE V here

The data from Table V show clearly that the Greek economy as a whole became much more open to international trade during the 1980s. It also shows the relatively more rapid growth of import penetration as compared to export performance. Given that a significant portion of import penetration was due to manufactiured consumer goods, this signified that consumer preferences rapidly shifted in favor of imported goods. The shift need not have displaced purchases of domestic products exclusively, but

could also include new demand. The specific analysis of import penetration has been conducted successfully by others, so that it is not necessary to repeat here the body of its findings [f] ; one can however draw an important conclusion: import penetration was the expression of a more fundamental phenomenon which took place rapidly after Greece's accession to the Community. This was the move towards a harmonization of the consumption basket of the average Greek consumer to the consumption basket of the average consumer in Community partner countries. Since this process of harmonization did not depend but on individual preferences and behaviors, it could unfold reasonably quickly under conditions of tariff elimination. In the opinion of this writer the rapid process of consumption harmonization testified to the existence of mature expectations about what entry of Greece into the EC would mean: adjustment of the living standard (both in terms of level and composition) to the European benchmark. Inasmuch as internationalization of consumption was an expected outcome of Greek entry, business strategies focused on facilitating the requisite import penetration, and thereby the rapid adjustment was brought about.

The second point regarding the adjustment of the consumption basket relates to the other pole of the "syndrome" of the early 1980s: the rise of Socialists to power. If membership in a Community of wealthier nations fostered general anticipations of higher and more "European" living standards, the election of Socialists to power extended the social breadth of these anticipations by the promise of a more egalitarian distribution of income. This effect of the Socialist platform on social expectations was not to remain a graduated set of anticipations extending into the future. It was rapidly supplemented by actual policy in the early period of the Socialist government, which focused on immediate income expansions (via salaries and pensions), thereby furnishing the process of consumption adjustment with the necessary means, and consequently shortening its time span.

In the sphere of production the adjustment to EC entry has embodied phenomena which are considered negative in most respects. The first and obvious response to import penetration has been naturally a reduction of demand for competing domestic industries and a shift of market shares in favor of foreign suppliers. Yet, one must also examine the response of export intensity of domestic producers since it is possible that increased exports counterbalance the expansion of import penetration. As we have seen in Table V, the growth of exports did not match the growth of imports at the level of the economy as a whole. More detailed analysis of manufacturing production and trade verifies the same relation with respect to the manufacturing sector, specifically [f]. The squeeze on sales and profits which has resulted for domestic firms has inevitably led to a process of shrinkage of domestic manufacturing activity, which has been aptly described as "deindustrialization". One prominent student of the effects of trade on domestic manufacturing activity since EC entry, finds that at the level of individual 2-digit manufacturing sectors, and over the interval 1980-87, there was deterioration in 15 out of 20 sectors, and that those 15 sectors accounted for two thirds of manufacturing value-added in the country before accession to the Community. He also finds that for manufacturing as a whole, domestic producers lost about five percentage points of their market share over 1980-87 and that the losses were distinctly concentrated in traditional "flagship" areas of earlier Greek manufacturing growth, such as food, beverages and textiles [f]. More microeconomic evidence has added to this general picture an additional finding: Within the overall decline of activity, larger firms have declined more and as a result the shares of smaller firms into total activity has risen [f]. Thus, the overall shrinkage has also had restructuring effects, both between sectors and between firms sizes within sectors. These findings must be now correlated to another important aspect of structural

adjustment in the Greek economy: The expansion of the underground economy.

The underground economy in Greece has been the subject of several empirical investigations using a variety of methodologies; all of them appear to converge on the conclusion that the underground economy exhibited a significant net expansion in the 1980s. One set of estimates based on the monetary method, (which I consider the most credible for Greek data), concluded that whereas in the 1970s, the underground sector represented about one fifth of official GDP, in the 1980s its relative weight grew consistently to attain a level of about 31 percent of official GDP in 1988 [f]. This implies that whereas official GDP grew at an average annual real rate of 1.6 percent over the interval 1980-88, the underground economy grew at an average annual real rate of 6.7 percent. Thus, while the official economy was experiencing stagnation, the underground economy was mounting its own "economic miracle". Unfortunately, one cannot really argue that as a result of this significant underground flourishing, the problems of the Greek economy are imaginary!

The most persuasive interpretation of the growth of the underground economy in the particular country and at the particular time is that this growth constituted a form of feasible adjustment to the pressures of international competition. On one hand the elimination of tariff protection which occured rapidly after Greek entry into the Community, created strong incentives for firms (especially small ones) and individual producers to seek niches of natural protection within the domestic economy. This implied that a reallocation of activities and resources would take place away from internationally competitive activities and towards internationally uncompetitive ones, or in other words from the sector of traded to that of nontraded goods and services [f]. Furthermore, as competitive pressure squeezed profit margins, the retreat to the

underground represented a viable strategy - possibly thwe only one available - whereby the shortfall of profits could be countered by tax or social security evasions.

If this interpretation is correct it carries three very significant implications. The first is that the type of adjustment represented by the growth of the underground economy is compatible with de-integration rather than with integration, since it reinforces defensive retrenchments into non-traded sectors of activity. Eventually, and as integration proceeds, this retrenchment will be exhausted, non-traded sectors will become more squeezed, and a latent crisis will emerge even in the underground economy. The second is that the retreat to the underground, as a method of salvaging profitability at the expense of the public fisc, constitutes a form of de facto public subsidy forcibly carved out of specific socio-economic conditions by the economic agents of underground activity. Presumably, a different set of policies could capture the revenues which evade via underground, and utilize those revenues to return infrastructural services to potential or actual entrepreneurs, thereby offering a strong counter -incentive to underground retrenchment and neutralizing the growth impulses of underground activity. The third implication of underground adjustment consists of organizational and technological limitations on growth potential. Underground activities cannot as a rule be organized in large units, cannot become importers and users of advanced technology, cannot function as carriers of innovative investment policies. Thus, whereas the net reallocation of activities from the official to the underground sector can generate disposable incomes as it is happening, it faces great limitations in generating intrinsic growth in incomes for activities already located in the underground sector.

The focus on major forms of adjustment to international competition must not obscure however a few positive signs which are also available.

Selected sectors in manufacturing, and certainly specific firms, have attained high levels of export performance. Furthermore, Research and Development activities, both public and private, have exprienced significant growth in the 1980s [f]. Perhaps, these few good signs foreshadow the course of more permanent adjustments to come. Nevertheless, the major phenomena are discouraging.

The basic conclusion from this section is that Greek adjustment to international competition has been fundamentally individualistic, unprogrammed and anarchic. Consumers adjusted their behavior on an individual basis, and many producers also adjusted on an individual basis, by retreating underground. These are not in themselves irrational responses. They simply constitute sums of private rationalities which however do not add up to a developmental track for the national economy. Private rationalities unguided by policy stimuli are apparently not capable to produce self-regenerating growth in the Greek economy. The primary forms of adjustment which have appeared divulge a lack of policy. At best, the Greek state offered its economic self-liquidation as the ultimate and the only policy towards adjustment; in the 1980s this was an outcome of non-policy which allowed economic agents to forcibly capture a subsidy by underground flight. In the 1990s, it is legitimized as a policy of privatization. Yet, it remains the privilege and the responsibility of public policy to supply infrastructure, institutions of regulation, as well as macro-economic stability in nominal terms. These objectives are inconsistent with self-liquidation of the state, or to put it more generally, self-liquidation is a negative policy which could possibly purge state practices from antiquated forms of operation; it is highly doubtful whether it can bring about positive desiderata, such as forms of adjustment to international competition which will be compatible to European integration.

E. Capital Mobility and the Desiderata of Future Public Policy

The fundamental feature of intra-European competition in the 1990s and beyond will be capital mobility. This is especially relevant for Greece which has been sheltered from capital mobility so far, due to special transition arrangements in the Community [f]. Whereas in the 1980s, the primary effect of Greek integration into the EC was felt in the area of competition through trade, i.e. the movement of goods, in the 1990s it will shift to the area of competition through investment, i.e. the movement of capital. Several factors support this prediction. First, the realization of the Single Market will bring to the fore new opportunities for investment, relocation of production and more general reallocation of capital among regions of the EC, and these functions will inevitably stimulate capital movements. In addition, the process of economic restructuring in Eastern Europe will reinforce the previous tendencies and will add its own stimuli to movements of capital, investment planning, and internationalization of production on a European continental scale. Both official and private capitals will be reallocated on a much grander scale in the next decade than they were in the last one, within Europe.

The fact that Greece has for a long time placed constraints on the (outward) movement of capital has led Greek investors to portfolio compositions which are very different from that which would have been chosen under a regime of free capital movement. The official liberalization of capital movements will therefore stimulate portfolio adjustments which could take the form of both outward and inward movements of capital. Outward movements will occur on the part of those investors who were constrained to a low level of international diversification, especially the

so-called institutional investors who cannot normally bypass official restrictions on financial investments. Inward movements could conceivably occur on the part of those investors (mostly individuals of high wealth or high corporate connections) who broke the previous rules of capital export restrictions, engaged in capital flight in the quest for secure international placements, and ended up overinvesting in international financial assets. Some of the recent gyrations of the Athens Stock Exchange can possibly be explained by this type of inward capital movement and portfolio-type readjustment. The capital movements which will arise from this type of adjustment will primarily affect financial investments and their rates of return. Yet, as many have argued, financial returns exert both direct and indirect influences on the entire investment process in a particular economy. Thus, whereas a large inward capital movement will ameliorate the terms for all types of domestic investment, large outward capital movement will contribute to a deterioration of both the "investment climate" (i.e. the system of expectations regarding investment) and the actual realization of investments. It is also possible however that, in the context of liberalized capital movements, financial investments will exhibit high turnover rates (i.e. frequent transformations between Greek and international financial assets), thus creating volatile conditions in domestic financial markets and relatively high risk-premia on long-term placements in Greece. This condition would be consistent for example with a scenario whereby very active financial markets continue to coexist with a stagnation of real investment.

From the perspective of institutional arrangements in the EC, the quickening process of financial and banking integration as well as the movement towards Economic and Monetary Union will affect capital mobility. They will contribute to make it a more important and more central

feature of the European economy. To explain briefly, financial integration and the unification of banking and finance practices across the Community will progressively allow not only free estabilishment of banking and financial service firms in every EC country, but also the free provision of cross-border financial services of a great variety [f]. These institutional arrangements will provide a wide and effective supporting mechanism for the mobility of capital, which did not exist before and which will bring about a qualitative change in the ability of capital to change forms, uses, and locations within Europe. Thus, mobility of capital will be not only stimulated on the side of new investment opportunities but also on the side of provision of financial facilities for easier movement.

The prospective move to Monetary Union, and more generally the progressive stabilization of exchange rates within the EC, will also affect positively the mobility of capital, from still another standpoint. The stabilization of intra-Community exchange rates will limit those movements of capital which are stimulated by hedging or speculative motives on exchange markets. In that case, the differences in returns to capital among Community countries will reflect much more directly the intrinsic efficiencies of various uses of capital, rather than the expectations of returns generated by exchange value fluctuations of the currency in which the particular uses offer their returns. Or, to put it more simply, movements of capital will be more directly stimulated by intrinsic return differentials than by expectations of exhange rate movements. In fact, in an unstable exchange rate regime most capital movement can be limited to liquid capitals which can rapidly respond to expectation reversals or unanticipated shifts; on the contrary, in a stable exchange rate regime, capital movement can be extended to capitals which are earmarked for longer-term commitments and which would not normally venture to new

uses under very volatile exchnage rate conditions [f]. If this argument is correct it implies, in short, that mobility of capital in Europe will extend to classes and types of capital which were considered immobile under previous institutional arrangements. Hence again, a general move towards more mobile capitals as a whole is predicted.

The implications which higher capital mobility holds for the Greek economy are not limited to a forecast of whether the net capital movement to the country will be positive or negative. They will be much broader because higher capital mobility implies more direct competition among countries and national authorities within the Community to attract capital. In this competition, national economic policies will play a significant role, and they will have to be shaped themselves as competitive instruments. This is a notion which is widely accepted about monetary policy, for example, but less widely admitted with respect to other aspects of public economic policy. Thus in the case of monetary policy, it is readily accepted that higher capital mobility will lead to European-wide interest rate equalizations if combined with stable exchange rates [f]. This will in turn imply a severe limitation on national monetary policies, or in other words, that these national policies will be restricted because of competitive conditions in Community-wide money markets, in combination of course with the political commitment for exchange rate stability.

Monetary policy and its instruments concern primarily short-term capitals which are responsive to short-term interest rate changes. The extension of capital mobility to medium and long-term capitals however, which is after all an essential element of European unification, means that other aspects of public policy, besides interest rates, will come into play in the competition for capital attraction. Here we must consider three helpful propositions:

(a) The rate of return to capital within any particular national jurisdiction is composed always of a "pure" private return {r} plus a modification {y} due to public policies (i.e. taxes, provision of public goods, regulations, price restrictions on inputs or outputs and the like) [f]. In the context of generalized capital mobility, the specification of {y} within each national jurisdiction becomes a competitive outcome, rather than just an outcome of the internal workings of national political systems.

(b) Although in principle the Single Market, and even more so the EMU, will sanction the freedom of both capital and labor to move across national boundaries, in practice and on average, capital will be more mobile and sooner than labor [f]. Even among capitals however, some will prove more mobile than others, as for example in the case of immobilized industrial investments or in the case of non-performing bank loans. As a consequence some factors of production will enjoy more options than others. In the first instance, mobile capital will be in a position to arbitrage between national regulations, whereas immobile labor will have to seek modes of protecting its interests only through the internal political-social system in its country of domicile.

(c) Although the specification of {y} will be subject to competitive influence, its composition can vary across jurisdictions and can respond to pressures and choices which operate within national political systems. Thus, for example, whether a modification of returns to capital occurs through tax forgiveness or through provision of infrastructures is a question which will be largely resolved by internal policy conflicts and or consent [f]. What is however necessary to take into account is that countries with low (or ineffective) infrastructures at the start of the process will feel great competitive pressure from countries with high-effective infrastructures.

Upon simple reflection the implication of these propositions for Greece is relatively straightforward but momentous. Entering into a competitive arena for the attraction of capital, Greece will be competing with more advanced partners who, on average, dispose of a higher supply of infrastructures and related public goods in the competitive game for mobile capitals. Furthermore, the same more advanced partners also dispose of a more reliable and more reputable set of institutional arrangments regarding the stability and the regulation of the economic environment of capital operation. In effect, Greece's disadvantages in both infra- and super-structures will have to be faced by policy. In terms of design and implementation, the easiest policy would be to attempt to counter the disadvantages by direct monetary compensations. Thus, one option would be the offer of tax forgiveness, or even negative taxes in the form of direct monetary inducements, to mobile capital. This is by and large the type of policy Greece has been sliding into over the last two decades, and with increasing intensity every time its need to attract capital became severe [f]. There are serious limitations to such a policy however, both in the short and especially in the medium or long term.

The first limitation is that Greece already has one of the lowest effective tax burdens on corporate profits and one of the most generous incentive laws for investment among all its European partners [f]. Beyond a certain limit however, both these tools become counterproductive. Tax forgiveness to corporate profit can backfire politically if it becomes extreme and if it implies - as it does in Greece - an inordinate tax burden being placed on salaries and wages. Investment incentives beyond a certain level, and if remaining in place for a long time, have a tendency to become subverted by generating behaviors which maximize the receipt of subsidies per se rather than optimizing investments.

The second limitation is that tax forgiveness and monetary incentives can always be changed under appropriately tense political circumstances. They may therefore not inspire sufficient confidence to long-term investors, even if the present level of inducements is very high [f].

Given the severe limitations of policies of current inducements in a competition with more advanced economies, it is clear that the alternative component of public policies must carry a much greater weight than it has so far, and than is obvious under prevailing poltical thinking in Athens: provision of infrastructures and related public goods must become the central element of Greek policy vis-a-vis the emerging competition and capital mobility in Europe. This is all the more necessary since, as we have seen in a previous section, public investment has been lagging to very low levels in recent years, and since the lacunae in the more essential infrastructural elements of the Greek economy are by now detectable even in the experience of casual observers [f].

It should be recognized directly that if this logical choice becomes accepted, it should force a decisive reorientation of Greek economic policy, and it would require significant institutional reform of the fiscal mechanism if it is to be effectively carried out. It should also be recognized that this reorientation of policy is probably the only strategy which is capable, in the medium term, of retaining EC commitments on resource transfers to Greece, since European political winds indicate that income-related transfers will become increasingly unacceptable, whereas investment-related transfers will maintain their legitimacy at the Community level [f]. Lastly, a reorientation of public policy towards a core of investment-in-public-goods activities will encourage the importation into Greece of perhaps the most valuable "service" that membership in the EC can offer: knowhow in the design, implementation, effective utilization

of public investment, in other words investment discipline.

The content of a policy reorientation towards public investment is possible to describe generally, by observing the main differences between Greece and its partners, but it obviously requires detailed study since Greek peculiarities and special conditions must be embodied. In a general view, physical infrastructures for transport, urban living, and industrial research, education, and information supply-transmission-processing mechanisms are priority areas for the creation of public goods.

The organization of a policy reorientation towards public investment presents a problem which can be superseded if two prerequisites are satisfied. First, the status of public investment within the broader scheme of fiscal management must be changed from what is now in effect a residual area, to an area of primary commitment. Secondly, this area of primary commitment must be placed outside the reach of the political-fiscal cycle. The necessary condition appears to be an organizational separation of the investment function from the current budget of the state, as opposed to the merely nominal accounting separation that has existed for years [f].

The finance of an upgraded public investment activity will generally meet with improved terms if segregated from the general finance of the Greek budget for several reasons: it will be easier to obtain European resource transfers, as already noted; it will not be operating under the burden of "creditors doubt" of general public borrowing, where the use of funds is unclear and inevitably gravitates towards public consumption; it will even be easier to legitimize taxes or contributions earmarked for the investment program as opposed to general public spending.

F. Concluding Remarks

It is clear that in order to procure development within an integrated Europe, Greece must break with its economic past and join a new future course. Breaking with the past means breaking the political - fiscal cycle and eliminating the attractions of underground economic flight. These cannot be done under a regime of administrative duress. They must be achieved consistently with maintenance and strengthening of democratic institutions. There are no doubt many prerequisites that political scientists would prescribe much better than this writer for the task. At the level of economic policy and the institutional coverage of economic policy however, a strong prerequisite is the rejuvenation of public investment and the acceleration of infrastructural capital formation within society. Such a reorientation of policy is the only means capable for the promotion of private investment as well and, more generally the only credible long-term tool for competitive national participation in a Europe of highly mobile capitals. Fundamentally, this implies a need for a "competitive national state", just in the same manner that economics textbooks propound the need for competitive firms. A competitive national state is not protectionist in the traditional sense. On the contrary, it is premised on open and integrated economies. Yet, it is protectionist in a different sense: it seeks to protect the integrity of its society which will include the factors of production with less mobility, and which will therefore still impose the need for a national definition of "development" and "economic welfare".

TABLE I : Growth and Investment Rates

	Growth Rate of GNP	Private Investment to GNP	Public Investment to GNP
1961-65	7.8	16.2	7.7
1966-70	6.7	19.3	7.7
1971-75	5.7	18.9	8.0
1976-80	4.2	17.5	5.4
1981-85	1.5	13.0	6.3
1986-90	1.8	12.5	4.9

Source: National Accounts of Greece, various years

TABLE II: External and Fiscal Deficits (as % of GDP)

	External Deficit	Fiscal Deficit
1961-65	3.5	n.a.
1966-70	3.0	3.0
1971-75	2.6	4.6
1976-80	1.5	5.2
1981-85	4.5	12.4
1986-90	3.2	17.6

Source: National Accounts of Greece, various years

TABLE III : Basic Fiscal Magnitudes 1980-89

Year	Receipts	Expenditures	Deficit as % of GNP
	(Billion Drachmae)		
1980	359.8	423.1	3.6
1981	446.0	733.1	13.6
1982	615.1	794.3	6.8
1983	750.9	1055.2	9.8
1984	955.8	1470.1	13.5
1985	1125.9	1776.9	14.2
1986	1501.4	2166.5	12.2
1987	1768.1	2748.3	15.8
1988	1991.7	3717.9	23.1
1989	2197.9	6698.5	27.5

Note : Expenditures do not net out the rollover of short-term debts

Source: Public Accounting Records, various years

TABLE IV : Growth Rates and Elections

Average Growth Rates in:	
Election Years (1981,1985,1989)	1.77
First Post-election Years (1982, 1986, 1990)	0.96
Second Post-election Years (1983, 1987)	-0.52
Third Post-election Years (1984, 1988)	3.15

Source: as in Table I