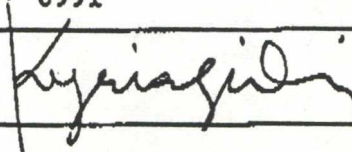


Facsimile Service Cover Sheet

Number of pages (including cover sheet)		Message number		Date
6				9.17.87
To	Name of addressee (type)			
	<div> <div> -- H.E. Constantine Simitis Minister of National Economy Ministry of National Economy </div> <div> -- Mr. N. Garganas Special Advisor to Minister Ministry of National Economy </div> </div>			
	<div> -- The Honorable Demetrios Chalikias Governor Bank of Greece </div>			
	Facsimile telephone number 323-0801			
From	Name of sender (type)			
	<div> Mr. Nikos Kyriazidis Alternate Executive Director IMF </div>			
Text or special instructions				
Please find attached my statement on Greece for the Executive Board Meeting of the IMF on September 18, 1987.				
Department and division (type)		Extension (type)		
OED		6991		
Authorized by (type)		Signature		
Nikos Kyriazidis				

Statement by Mr. Kyriazidis on Greece
Executive Board Meeting No. 87/143
September 18, 1987

I wish first to express my authorities' deep appreciation at the constructive and frank discussions that took place during the consultations and their high regard for the quality of the mission's report.

The main conclusion of the mission's report appears to be that although progress towards adjustment has been made as a result of the stabilization program introduced two years ago, it has been slower and weaker than expected and indeed desired. My authorities are perfectly aware of the weaknesses and shortcomings of developments in the past two years so that they have no difficulty in agreeing with the staff's main conclusion. However, they feel that the results so far achieved have not been inconsiderable and their significance should not be underestimated.

The original targets were first, the rapid deceleration of inflation to 16% by the end of 1986 and 10% by the end of 1987 (not including the effect of the introduction of the VAT) and second, the reduction of the current account deficit of the balance of payments from \$3.2 billion in 1985 to 1.7 billion in 1986 and 1.25 billion in 1987. These targets have by and large been achieved. Inflation decelerated from an annualized rate of 33.5% during the last quarter of 1985 to 16.9% by the end of 1986 and, despite some unfavorable developments due mostly to extraordinary factors, (such as the effect of the severe winter, the higher than expected impact of the introduction of VAT, the upward adjustment public utility and administered prices, and the lifting of the price freeze) has further decelerated in the first eight months of this year to a rate that can reasonably be expected to be lower by about 3 percentage points in comparison with 1986.

The current account deficit of the balance of payments has also been reduced from \$3.2 billion in 1985 to \$1.7 billion in 1986. The staff correctly points out that some significant favorable exogenous factors such as the decline in oil prices and increased transfers from the EC contributed substantially to the achievement of the government's target. However, there were also negative exogenous factors in operation which have not allowed the underlying adjustment trend to manifest itself fully. The extent of this underlying adjustment has, however, become more apparent in 1987 and is reflected in the continuing growth of exports and the vigorous increase in receipts from services and private transfers. As a result, in the first 7 months of the year, as shown in the staff's supplementary paper, the balance of payments deficit on current account has declined from \$1.38 billion in the corresponding period

of 1986 to \$1.1 billion. This combined with a strong recovery of non-debt creating private capital inflows has led to an increase in official foreign exchange reserves by \$800 million, i.e., an amount equal to the net new foreign borrowing contracted this year. Thus, the achievement of the government's primary objective namely to reduce the current account deficit in the balance of payments from 10% of GDP in 1985 to 3%, i.e., by 7 percentage points by 1987, appears to be not only attainable but indeed probable.

The weak point in the development of the foreign balance is the continuing growth of import demand. This is a cause of concern to the government as it appears to reflect not only domestic over-absorption which can be corrected by macroeconomic adjustment or delayed but reversible J curve effects, but also increased import penetration due to liberalization combined with structural weaknesses in domestic supply.

The authorities cannot agree at this time with the staff recommendation that further increases in competitiveness in order to achieve a better performance in the trade balance should be sought by a more rapid slide of the real effective exchange rate because of the risks that such a policy contains of refueling inflationary expectations and encouraging pressures to use exchange rate policy as a substitute for wage moderation and fiscal and monetary restraint. Their intention is therefore to stay on the present course of policy which consists in compensating inflation differentials so as to maintain the degree of competitiveness achieved through the devaluation of 1985.

In the view of the Greek authorities, sustainable gains in competitiveness are to be sought through continued labor cost deceleration increased productivity, the maintenance of the appropriate monetary fiscal policies and the encouragement of private investment. In this respect, it is encouraging to note that the incomes policy, the restoration of competitiveness through the exchange rate policy pursued over the last two years and the extensive liberalization of prices have led to a substantial increase in profitability in the private sector, a radical improvement in business confidence and a recovery of private investment. According to recent estimates by the National Accounts Service, private investment increased in real terms by 5% in 1986 and is expected to rise by 9% in 1987. Another indication pointing in the same direction are the results of the latest survey of business intentions by the Industrial and Economic Research Institute sponsored by the Confederation of Greek Industries according to which investment in manufacturing by the firms responding to the survey is expected to increase in 1987 by 58.7%, as compared with 20% in 1986. These figures as well as the recovery of private capital inflow are sufficiently indicative of the restoration of business confidence and the strong improvement in the investment climate achieved by the stabilization program. These trends are expected to continue in 1988.

- 3 -

The public sector borrowing requirement has also been reduced by 4 percentage points of GDP in 1986, and is expected to be further reduced in 1987. It is in this area, however, that the principal slippages have occurred in 1987 which constitute a major cause of concern for the authorities. The overshooting of expenditures in the social security sector is chiefly responsible for this unsatisfactory development. Corrective measures chiefly on the expenditure side of the government budget were taken last June corresponding to 2% of GDP as described in the staff report but their results are not as yet apparent in the figures so far available so that no reliable estimate of the fiscal outcome in 1987 can be presented at this time.

The slippage in the fiscal sector has unavoidably been reflected in the development of the monetary and credit aggregates as presented in the supplementary paper of the staff. It is interesting to note however that the shortfall in the expansion of domestic credit to the private sector is not a crowding out phenomenon but rather the result of a sluggish demand for credit at least in part attributable to the rise in real interest rates and the enhanced liquidity of the business sector resulting from the release of advanced import deposits and higher profits.

On the other hand, significant progress has been made towards reducing the structural rigidities of the credit system and adjusting the interest rate structure to prevailing financial conditions. As a result of the measures taken, interest rates on more than half of commercial bank credit are now market determined and the entire interest rate structure on both loans and deposits is positive in real terms as deflation has decelerated.

Some progress has also been made, though unhappily much smaller than hoped for, with regard to the sale of government paper to the non-bank public. From inauspicious beginnings early in the year, the market has developed a clear positive interest which appears to have intensified in the summer following the increase in the yield of Treasury bills so that although the targets originally set are not likely to be achieved by a wide margin, it can be safely expected that progress in this field will accelerate in the latter part of the year and especially in 1988. I would like to add that the authorities are very positively inclined to the staff recommendations on this score and are ready to experiment with various forms of paper and marketing techniques in order to expand rapidly the money market and the ability of the public sector to borrow outside the banking system on market determined conditions. Furthermore, the government has officially endorsed the recommendations of the report of the task force on the reform of the credit system (described in Appendix V of the RED) and has entrusted the Bank of Greece with its implementation as rapidly as possible.

The government is determined to pursue the adjustment effort in 1988 and beyond. Their basic strategy would remain fundamentally the

same although in view of the experience of the past few years, which has proved the importance of the relaxation if not elimination of structural rigidities for effective macroeconomic management, it is also determined to give priority to structural reforms.

Macroeconomic targets for 1988 have not yet been quantified. They will be announced with the budget at the end of November. The major guidelines however have already been made clear.

The immediate targets for 1988 are the further deceleration of inflation hopefully to a single digit figure and a further improvement in the balance of payments on current account which will permit at least the stabilization of the external debt. To this effect:

a) incomes policy will be directed towards ensuring continued moderation in wage increases although through a more flexible mechanism than the one applied in the last two years.

b) fiscal policy will be directed towards a further significant reduction in the PSBR based not only on stricter expenditure control but also on significant structural reforms in the tax system.

c) monetary and credit policy will be adjusted to support the achievement of the inflation and balance of payments targets and respond to financial conditions rapidly and effectively both through timely corrective action whenever required and additional structural reforms on the lines of the Task Force report.

On the fiscal front the official directives on the basis of which the budget for 1988 is being prepared are: a) the strict containment of current expenditures including a hiring freeze already in place and b) a revision of the income tax structure aimed at an expansion of the tax base, and a more efficient curbing of evasion. Within this framework and provided that progress towards reducing the fiscal deficit permits, some adjustments of the income tax scale will be envisaged in order to reduce fiscal drag and incentives to the black economy and relieve the pressure for upward real wage adjustments.

With regard to public enterprises, in accordance with the restructuring program which is already being implemented, strict rules will apply as to expenditure through close monitoring of both general expenses and stock control. In addition, medium and long-term investment expenditures will be approved only on the basis of feasibility studies supported by appropriate cost-benefit analysis, while prices will be determined on the basis of marginal costs with due account to financial charges. Pricing policies however will remain under close monitoring so as to ensure that price adjustments are not used to cover inefficiency.

The major problem in the public sector continues to be the deficits of social security entities, the expenditures of which are notoriously rigid as many countries' experience has shown. It is clear that it is a problem of a structural nature, the solution of which can only be sought in the medium term through fundamental reforms which require careful study and consultation with the social partners. The government has appointed a Task Force of experts to study the matter. The committee's report is expected in the first few months of 1988. However, these problems are notoriously prone to create serious social and political difficulties and the introduction and implementation of reforms has to proceed with care.

An appropriate incomes policy continues to be a central instrument in the government's adjustment policies. As indicated in the report, the authorities have felt that the rigidity of the incomes policy applied since October 1985 had to be relaxed after the end of the two-year period stipulated by the legislative decree under which it was introduced. The staff concurred with this view. The specific details of the new policy have not been determined yet. However, the general framework has been announced by the Prime Minister and the Minister of National Economy at the beginning of this month. The main elements are the following: First, in the public sector, salary adjustments will continue to be determined on the basis of the modified indexation mechanism that has been in force in the last two years. Second, in the public enterprise sector additional adjustments related to productivity will be allowed on condition that they do not serve as a pretext for general salary increases. Third, in the private sector nominal salaries will be allowed to be determined through collective bargaining. The basis will be the modified indexation adjusted in order to permit some flexibility with regard to wage differentials. The system will be operated according to guidelines to be established by the government after consultation with the social partners and within the framework of the safeguards that are in place, particularly with regard to compulsory arbitration. Productivity bonuses will be allowed after negotiation with the employer at the enterprise level on the basis of results obtained and not in anticipation.

The government is fully aware of the inevitable uncertainty involved in this process. It is, however, firmly committed to managing the policy in such a way as to prevent wage and salary increases that could undermine the pursuit of deceleration on the inflation front or the maintenance of external competitiveness. The first signal in this direction is the maintenance for the public sector of the strict system applied during the past two years.