Greece: the long process of economic and institutional convergence

(From association with the European Economic Community to accession to the European Communities and then to EMU membership: 1961-2003)

Isaac Sabethai

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1. Introduction: The Association Agreement (1961-1980) and the preparation for accession

Greece signed an "Association Agreement" with the European Economic Community in 1961; however, this was virtually suspended during the seven-year military dictatorship (1967-1974). Following the re-establishment of democracy in 1974, Greece applied in 1975 for full membership in the European Communities. Both the government and a strong majority of the citizens hoped that participation in a larger European family of democratic and economically developed nations would eventually lead to economic prosperity and modernization. Perhaps more importantly, they hoped that membership would also strengthen and protect the democratic regime, foster political stability and guarantee peace with Greece's neighbors. It was particularly hoped that membership would favor the peaceful resolution, within the European family of countries, of any differences with Turkey.

The long and arduous negotiations that followed[2] led to the Treaty of Accession, which was signed in May 1979. The Treaty stipulated a period of transition of five years for many issues, seven years for the free movement of workers and two years for certain items of the *acquis communautaire* related to social policy. An examination of the debate leading to this negotiated outcome, e.g. concerning the free movement of labor and social policy,[3] may be instructive for most of today's acceding countries. Concerning *free movement*, the EEC member countries were not afraid of Greek immigration. Hundreds of thousands of Greek workers had emigrated to West Germany in the 1960s, but a return wave was already under way in the late 1970s, *inter alia* because the Greek economy was

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[1] *The opinions expressed in this paper are the author's and do not necessarily reflect those of the Bank of Greece.*

[2] From the point of view of the Commission of the European Communities, two important documents concerning these negotiations are: (a) *Avis sur la demande d' adhésion de la Grêce (29 janvier 1976), Bulletin des Communautés européennes,* Supplément 2/76, and (b) *Economic and sectoral aspects: Commission analyses complementing its views on enlargement,* COM(78)200 final, Brussels, April 27, 1978 (also known as the "fresco").

[3] See Sabethai, I., "Free movement of workers and social policy", in: Mitsos, A. *et al.*, *The Accession to the European Communities* [in Greek], 1981.

growing faster than the West German one at the time. The European Commission, however, wanted to set a precedent for Spain and Portugal, because it was concerned about possible migratory flows from these two candidate countries that were to become members in 1986. Concerning *social policy*, it was the Greek government who asked for a two-year transitional period in order to implement two important directives on workers rights,[4] because it felt that it was not yet ready to introduce worker-management consultation at the enterprise level, as the directives stipulated.[5]

2. *Accession and membership: the first phase (1981-1993)*

Greece joined the European Communities in January 1981. In the first thirteen years of EC membership (1981-1993) there was a major effort to maximize the benefits and offset the possible disadvantages of accession. In this period, the slow maturation of the Greek society, economy and institutions, which had started in 1974, was continuing. Greece had lagged behind Western European countries during the "interval" of the military dictatorship and was now trying to catch up in terms of democratic practices and living standards. Economic agents had to learn to operate responsibly in a free and competitive society, i.e. they had to become "social partners" and to stop expecting the State to act both as a "provider" of first *and* last resort and as a policeman (and/or mediator). On their part, governments had to accept that a share of power had to be ceded to civil society. Governments also had to learn to avoid the temptation of using fiscal policy (and economic and social policy in general) for short-term electoral gains and to the detriment of future generations. In the 1974-1993 period, for example, fiscal and incomes policies were indeed adversely affected by the electoral cycle. Governments were also influenced by the view that expansionary policy could lead to real income gains without increasing inflation; this view proved to be wrong, however, at least for the Greek economy of the time.

[4] These concerned collective redundancies (Directive 75/129/EEC at the time, today Directive 98/59/EC) and the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of businesses (Directive 77/187/EEC at the time, today Directive 2001/23/EC).

In the same period, the Greek economy had to respond to the challenge of trade liberalization, as it was feeling the impact of the lifting of trade barriers. To this end, it was aided by the inflow of Community funds, both for the support of agricultural incomes (under the Common Agricultural Policy) and for structural intervention (under various schemes, e.g. the "Integrated Mediterranean Programs", the "Cohesion Fund", the 1st "Community Support Framework 1989-1993" etc.).

Equally important were, first, the institutional boost provided by the transposition of EEC regulations and directives into Greek law and by their practical implementation, despite problems and delays, and, second, the influence of policy guidelines formulated at the Community level. For example, the years from 1982 up to 1990 witnessed the transposition into Greek law of EEC social policy directives on mass dismissals, protection of workers' rights in the event of transfers of businesses or employer insolvency, equal pay and equal treatment of men and women workers, etc.[6]

At this point, it is useful to dwell a little on the meaning and the purpose of EU's employment and social policy. The original Treaty of Rome (article 117) talked about improving the living and the working conditions of the labor force "through their harmonization while improvement is maintained"; additionally, articles 100 and 101 of the Treaty empowered the Council of Ministers to issue directives in order to harmonize provisions that have a bearing on the establishment and the functioning of the common market or in order to eliminate differences in national legislation that could cause distortions in the conditions of competition. This has been the legal basis of social policy directives; it is thus clear that this chapter of the *acquis communautaire* is intricately connected with a desire to provide a "level playing field" in the market and to avoid "social dumping".

The new "European" context led Greek governments, although they were under no formal obligation, to liberalize legislation on labor union rights (1982 and 1988) and on collective bargaining (1990)[7] and to introduce important elements of

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[5] At the time, labor relations were still quite tense in Greece. Compulsory arbitration (according to Law 3239 of 1955) was dominant as a method of settling collective labor disputes, and various restrictions had been placed on the right to strike and the right to organize (Laws 330 of 1976 and 643 of 1977).

[6] The directive on collective redundancies became Greek law in 1983 (i.e. on time); the one on workers' rights in the event of transfers took more time (until 1988); finally, Directive 80/987/EEC on employee protection in the event of employer insolvency became Greek law in 1990.

[7] Law 1264 of 1982 liberalized provisions on the activity of labor unions and the right to strike; law 1767 of 1988 introduced workers' councils at the enterprise level; law 1876 of 1990 repealed the 1955 law on compulsory arbitration and introduced voluntary mediation and arbitration (see also section 3

labor market flexibility (part-time and shift work, 1990). The end result of these various factors was a slow process of "Europeanization"[8] and modernization, marked by ups and downs in GDP, inflation (which was high or less high, fluctuating between 12-27%, but never low!) and real incomes, as well as by slowly rising unemployment. It is revealing that most of the restrictive policies and/or stabilization programs implemented in 1979-81, 1983, 1985-87 and 1991-93 did not yield permanent gains, although they *did* avert a further worsening of the economic situation.

3. *The second phase (1994-2000): preparing for EMU entry*

Things started to change since 1994, when the adoption of the new "1994-1999 Convergence Program of the Greek Economy" marked a qualitative shift in the economic policy mix. There was now more effective coordination of monetary, fiscal, incomes and structural policies towards the attainment of low inflation, of low

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below). One of the factors that led to the liberalization of labor relations was Greece's accession to the European Communities. A characteristic example of "European" pressure for liberalization was a statement made by the European Commission during the second phase of a long-lasting strike by bank employees protesting a unilateral government decision to change their hours of work. Actually, the statement was made on 25 January 1980, i.e. after the Treaty of Accession had been signed and before it became effective. The Commission said (in an answer to a question by a member of the European Parliament): "…By signing the Treaty of Accession, Greece has undertaken to comply not only with the original Treaties and secondary legislation, but also with the general legal principles recognized in the Member States, which, according to the settled interpretation of the Court of Justice, form an integral part of Community law (…). The Commission has no immediate plans to adapt the Member States' existing national laws on trade union freedom. This in no way detracts from applicant States' duty to adjust their laws to the *acquis communautaire*, which stipulates *inter alia* respect for the fundamental rights and freedoms enshrined in the legal orders of the present Member States (…). Analyzing Greek laws (…) is not necessarily a decisive method of establishing beyond doubt whether there is a violation of the principles of freedom of association. However, one may wonder whether the binding nature of arbitration, as laid down in (…) Law 3239 of 1955, does not constitute an infringement of the very substance of the right to strike, as enshrined in the fundamental rights and principles recognized in the present Member States" (Answer to Written Question No 906/79, *Official Journal of the EC*, C 49, 27 February 1980). See also: Sabethai, I., "Restrictions on the right to strike: legal provisions versus union action (a bank employees' strike in Greece)", Université de Bordeaux I, *Bulletin de droit comparé du travail et de la securité sociale,* numéro spécial 1982/2 (travaux de la conférence internationale de droit du travail organisée par l' Institut de l' Etat et du Droit de l' Académie Polonaise des Sciences, Varsovie, 21-25 septembre 1981).

[8] For the concept of "Europeanization" see: Featherstone, K. and Radaelli, C., editors, *The Politics of Europeanisation*, Oxford University Press, 2003; Featherstone, K. and Kazamias, G., editors, *Europeanisation and the Southern Periphery*, Frank Cass, 2001.

government deficit and debt compared to GDP, and of exchange rate stability, as the Maastricht Treaty demanded.

In the case of monetary policy, there was a gradual strengthening of its anti-inflationary stance, based on stabilizing the exchange rate of the drachma vis-à-vis the ECU (and then the euro).[9] This policy was easier to implement without serious losses of actual (as opposed to measured) competitiveness, since part of the real appreciation of the effective exchange rate of the drachma (which would normally indicate a loss in competitiveness) in fact reflected the catching-up process and the Balassa-Samuelson effect. In other words, the rise in the relative price level of Greece vis-à-vis its trade partners was partly the result of higher increases in the prices of non-tradable goods and services (which did not matter, at least directly, for competitiveness). In the case of tradable goods and services, large productivity gains reduced the inflationary effect of high wage increases and slowed down the erosion of the competitiveness of Greek exports.[10]

In the 1994-1999 period, the *steady* improvement in the economic situation came to mean that sacrifices were not wasted anymore. Moreover, since the improvement was *visible*, it helped to increase the credibility of the policies followed and made it easier for social partners to adopt a moderate stance with regard to wages and prices: thus unit labor cost growth slowed down to 2.5-3% in 1999 from approximately 20% in 1990. The most important point is that the 1994-1999 Convergence Program relied on a *balanced* set of policy guidelines. Thus, it managed to generate a "virtuous circle". Lower inflation (from 20% in 1990 down to approx. 2% in 1999) led to lower interest rates. In turn, these led to lower government deficits (which fell from 13.4% of GDP in 1993 to 1.8% in 1999). To

[9] See H. Voridis, E. Angelopoulou and I. Skotida, "Monetary policy in Greece 1990-2000 through the publications of the Bank of Greece", Bank of Greece *Economic Bulletin* [in English], Number 20, January 2003.

[10] According to the results of some IMF studies (IMF, *Greece: Selected Issues*, December 1999, chapter III, "The contribution of the Balassa-Samuelson effect to inflation: cross-country evidence"; IMF, *Monetary and exchange rate policies of the euro area: Selected Issues*, IMF Country Report No. 02/236, 2002, Chapter I; M. Kieler, "The ECB's inflation objective", IMF Working Paper, May 2003), as rendered comparable in a recent ECB study (*Inflation differentials in the euro area: potential causes and policy implications,* September 2003), on the basis of 1995-2001 data, the expected inflation differential between Greece and the euro area as a whole attributable to the Balassa-Samuelson effect would be of the order of +0.7 to +0.8 of a percentage point (compared to a normalized euro area HICP inflation rate of 2%). This implies that in 2002 and 2003, when euro area inflation has been slightly above 2%, the Balassa-Samuelson effect would account for approximately half the actual inflation differential between Greece and the euro area (HICP inflation in Greece was 3.9% in 2002 and is expected to be 3.5% this year). Also see: Bank of Greece, *Monetary Policy: Interim Report 2003* [in Greek]*,* October 2003, Chapter III.2.

close the circle, lower deficits led to even lower inflation. This also meant that the cyclical fluctuation of certain magnitudes was dampened considerably, thus fostering a climate of stability. Additionally, there has been uninterrupted growth of real incomes since 1994, which has supported the growth of private consumption.

Fiscal policy, however, was not steady enough in the early 1990s, as already mentioned. Also, there were cases when real wage increases exceeded productivity gains in the mid-1990s. Thus, after the hard drachma policy of 1990-97, devaluation and entry into the Exchange Rate Mechanism (ERM) became necessary in 1998. The inflationary effects of this devaluation were kept small, with help from the social partners and with the use of interest rate policy, which actually led to some appreciation of the drachma in 1999, and to capital inflows that had to be "sterilized".[11] Then, in 2000, following the decision (taken in agreement with EU organs) for a formal appreciation of the drachma's central rate within the ERM, the drachma started a slide, which led to full convergence of its market rate on its central rate by the end of that year. At the same time, interest-rate convergence was taking place.

Over the same period, inflows from the EU's Structural Funds (under the 2nd and the 3rd "Community Support Frameworks", 1994-1999 and 2000-2006 respectively) were quite helpful. According to a European Commission report,[12] inflows of structural funds amounted to 3.5% of GDP in the 1989-99 period.[13] It is estimated in the same report that at the end of this period the level of Greek GDP was 9.9% higher than it would have been in the absence of these inflows.[14] The inflows of Community funds, together with the fall in interest payments on the public

[11] See S. N. Brissimis (Bank of Greece), "Speaking notes [on monetary policy]" (unpublished), presentation to a visiting NBP delegation, May 20, 2003.

[12] *Second Report on Economic and Social Cohesion,* January 31, 2001.

[13] According to a differently based calculation, net inflows from the Community Budget (measured after including receipts under CAP and subtracting Greek contributions to the Community Budget) were equal to 3.2-4.5% of Greek GDP in the 1990-2001 period. See: Manassaki, A., "European Union transfers to Greece: historical background and prospects", Bank of Greece, *Economic Bulletin*, No. 12, December 1998; Bank of Greece, *Annual Report 2002*, 2003, Box IX.2. It has been estimated that these inflows contributed 0.8 to 1.2 percentage point to the growth rate of Greek GDP. See Bank of Greece, *Annual Report 2001*, 2002, footnote 5 on p. 47.

[14] Of course, there also exist different views on the subject. The *Economist* (March 27, 2003) quotes an anonymous "senior Greek official in Brussels" as claiming that "…the best thing the EU could do for Greece is to cut off the structural funds immediately (…); anybody who works hard at a regular business is regarded as an idiot, since it's much easier to set up a project to draw in European subsidies". There is a grain of truth in this view, since all good things can also be abused. The statement quoted, however, does *not* describe what *usually* happens, although it *does* indicate that there is room for more efficient utilization of EU funds.

debt, allowed government investment to rise fast without encountering problems of financing. This circumstance also helped to do away (for some time at least) with the short-run trade-off between inflation and growth. Business investment rose at record rates too, precisely because increased confidence in economic policy led to positive expectations and because firms wanted to prepare for tougher competition once within the Economic and Monetary Union.

By a historical coincidence, during this period, which immediately followed the changes of regime in Eastern and Central European countries, Greece became a country of net immigration. Foreign, non-EU immigrant workers mainly found employment in services (restaurants, hotels, household services, etc.) construction, small-scale manufacturing (especially textiles) and agriculture; their number gradually rose and today they make up approximately 15% of the labor force. Their economic activity contributes to GDP growth, strengthens flexibility and averts (or eases) bottlenecks in the labor market, helps to moderate labor cost growth and inflationary pressures, and augments the revenues of the social security funds. In this sense, the inflow of foreign workers in the 1990s has contributed both to the nominal and to the real convergence of the Greek economy. Government policy is to promote the social integration of legal immigrants.[15]

The 1990s were also a period of important structural reforms in the labor and the product markets.

In the labor market, the compulsory arbitration of labor disputes (which had been in effect for 35 years) was abolished and a new law concerning free collective bargaining was implemented in 1990. This, together with the abandonment of the automatic wage indexation system (which, with successive modifications, had constituted the basic mechanism for determining wage increases from 1982 to 1990), clearly had beneficial effects on wage bargaining. The abolition of compulsory

[15] During the first wave of legalization, which started in 1998 and ended in 2000, a large number of foreign, non-EU workers (225,000 persons, out of 373,000 who registered in the initial phase of the legalization procedure) managed to submit all the necessary documents (including proof of payment of social security contributions) and most of them became “Green Card” holders. These people are now integrated into the social security system, pay contributions and receive benefits. There had been common agreement, however, that the total number of non-EU economic immigrants was much higher. Thus, new legislation passed in March 2001 offered illegal workers residing in Greece for at least one year the chance to legitimize their status. This second phase of registration/legalization started in early June and went on until early August of 2001. During this two-month period, 351,000 immigrants applied for temporary residence permits. According to more recent data, 505,000 foreign (non-EU) workers are now registered with IKA (the main social security fund); of them, 243,000 come from neighboring Albania; *8,243 workers come from Poland*.

arbitration contributed to a healthier structure of the labor union movement (by objectively favoring the most representative unions); *it also contributed to the adoption of a more responsible bargaining stance*. The growing realization of some of the Greek economy's structural problems, combined with the lessons drawn from the restrictive economic policies followed in 1979-81, 1983 and 1986-87 and with growing unemployment, were additional factors that affected labor union behavior. Thus, after 1990 collective labor disputes settled by collective agreements (and not by arbitration, compulsory or voluntary) rose dramatically as a proportion of the total. Since 1991, almost all the National General Collective Agreements, which determine minimum wages, had a two-year duration. Moreover, strike activity showed a definite downward trend after 1990. Of particular importance, finally, is the fact that free and consensual bargaining, which gradually established itself since 1991, took government policy (e.g. the official inflation target) into account, but in a flexible and non-uniform manner.[16]

In the 1990-2000 period, important labor legislation concerned the implementation of active labor market policies, the legalization of foreign (non-EU) workers, the annualization of working time, the further promotion of part-time employment, the reduction of social security contributions for low-wage workers, the streamlining of the law on collective redundancies, etc.[17] Since 1998, National Action Plans for Employment have been drawn up by Greece (as by other EU countries); this has helped make employment policy more coherent.[18] Most of the above reforms have contributed to labor flexibility. The effect on unemployment was not very visible until 1999; in 2000, however, unemployment started to drop. The limited effect on unemployment mainly reflected the weaknesses of the educational system,

[16] Thus, the trade-union tactics adopted during 1975-90 were gradually abandoned in the period 1991-96 (if not by all, at least by numerous and important trade unions). These tactics had consisted in demanding very high wage increases at the start of negotiations in order to create an impression on union members. At the end, however, either comparatively low increases were agreed to and collective agreements were signed, or even lower wage increases -- awarded by the arbitration tribunals -- had to be accepted. In the latter case, the trade union leadership insisted that it did not bear any formal responsibility. See: Sabethai, I., "From contractual earnings to labor costs: Incomes policy, collective bargaining and inflation (1991-1996)" [in Greek], Bank of Greece, *Economic Bulletin,* No. 9, March 1997.

[17] OECD, *Economic Surveys: Greece,* 1996, Chapter III; Sabethai, I., "The Greek labor market" [in Greek], Bank of Greece, *Economic Bulletin,* No. 16, December 2000.

[18] Following the Amsterdam Treaty, the revised text of the Treaty establishing the European Community stipulates that Member States consider the promotion of employment a matter of common interest and co-ordinate their action -- which is to be supported and complemented by the Community -- to this end. This is why annual employment policy guidelines are now issued and national action plans for employment must be drawn up in order to implement them.

the relatively high tax burden on labor and the remaining product market rigidities. It should be pointed out, however, that the findings of the EU *Ad Hoc Labour Market Surveys,* which were conducted by the European Commission in all EU countries in 1999 among enterprises in industry, retail trade, and services, as well as among employees,[19] support the conclusion that the Greek labor market is characterized by a degree of *de facto* (rather than formal) flexibility much higher than what is usually believed or admitted.[20] Of course, some elements of rigidity are also recorded.[21]

In the 1990s important reforms were also undertaken with the aim of enhancing competition in product markets and reducing the size of the state-controlled sector of the economy. These reforms came under three main headings:

(a) The privatization program, which involved either full or partial privatization (as the case may be) of state-owned shipyards, oil refineries, banks and public utilities (e.g. in telecommunications, electricity, postal services, water services, port authorities, etc.). For all practical purposes, this program started in 1994 (as part of the 1994-1999 Convergence Program), received a boost in 1998 (at the time when the drachma entered the ERM),[22] and has since been expanded. Obviously, the privatization program, apart from improving market performance, has also helped public finances. In an earlier period (spanning part of the 1980s and part of the 1990s), governments had to face the problem of "ailing" (over-indebted) firms, mainly in the manufacturing sector.

(b) Market liberalization, which started with the opening-up of domestic air travel and of mobile telephony in 1992-1993 and went on with the opening-up of fixed telephony and of the electricity sector as of 2001; domestic sea travel followed in 2002.

[19] The detailed findings have been published in *European Economy: Reports and Studies,* No. 4, 2000. The survey among industrial enterprises was also conducted in 1994 and in 1989. For the older surveys, see *European Economy: Reports and Studies,* No. 3, 1995.
[20] See Bank of Greece, *Monetary Policy: Interim Report 2000,* November 2000, Box 3, p. 58.
[21] For a fresh view of rigidities in the Greek labor market (particularly those related to the tax and the social security system), see: Burtless, G., "The Greek Labor Market" in: Bryant, R.C., Garganas, N.C., Tavlas G.S. editors, *Greece's economic performance and prospects,* Bank of Greece and the Brookings Institution, 2001.
[22] The June 1998 *Update of the Hellenic Convergence Program 1998-2001* (http://europa.eu.int/comm/economy_finance/about/activities/sgp/country/countryfiles/el/el19981999_ en.pdf) contains a detailed exposition of the structural reforms on which the Greek government committed itself when the drachma joined the ERM.

(c) The establishment and operation of the Competition Commission and of regulatory authorities in various sectors (telecommunications, postal services, energy and domestic sea travel).

To the above, one should add the liberalization of the banking system[23] (which had started in the 1980s) and, of course, the establishment of the independence of the Bank of Greece.

There have been some clearly positive results in the field of product market reform. The opening up of the telecommunications market has led to lower prices, a wider range and higher quality of services, and an increase in employment. Some positive results have also been recorded in the domestic air transport market, although problems persist. In the electricity market, the opening-up is proceeding, but competition will take more time to become effective (heavy investment is required; some institutional wrinkles must be ironed out);[24] Greece has obtained derogation until 2006 concerning the opening up of the natural gas market. The domestic sea transport market was opened up only in November 2002.

All of the above, i.e. the new economic policy mix, the more mature attitudes of the social partners, the wide-ranging reforms in labor and product markets, and – on a different level – the inflows of EU funds and the large influx of foreign workers, resulted in Greece fulfilling all the *nominal* convergence criteria of the Maastricht Treaty by mid-2000 and becoming a full member of the euro area in January 2001. The *same* factors got the process of *real convergence* of the economy started in 1996.

In retrospect, the 20-year period between 1981 and 2001 was one of structural change in the economy, attributable partly to EU membership and partly to pre-existing tendencies. For example, the structure of production changed significantly. The primary sector's share in GDP fell from 14.5% in 1981 to 9.9% in 1995 and 7.3% in 2000.[25] The share of the secondary sector fell from 29.2% in 1981 to 22.4% in 1995 and 22.0% in 2000. The share of the tertiary sector rose from

[23] Eichengreen, B. and Gibson, H.D., "Greek banking at the dawn of a new millennium", in: Bryant, R.C., Garganas, N.C., Tavlas G.S., editors, *op. cit.*; OECD, *Economic Surveys: Greece,* 1995, Chapter III. Also see: Bank of Greece, *Monetary Policy: Interim Report 2003* [in Greek], October 2003, Annex to Chapter IV ("The development of the Greek financial system over the last decade").

[24] Mylonas, P. and Papaconstantinou, G., "Product market reform in Greece: policy priorities and prospects", in: Bryant, R.C., Garganas, N.C., Tavlas G.S., editors, *op. cit.*; OECD, *Economic Surveys: Greece,* 1998, Chapter IV.

[25] National accounts figures used for the 1974-1994 period are those estimated by the Ministry of National Economy in order to improve comparability with ESA 95 data for the period since 1995.

56.3% in 1981 to 67.7% in 1995 and 70.7% in 2000. External trade was also affected by EU membership, but not dramatically, since Greece had already been linked to the EEC with the association agreement since 1961. Exports of goods and services rose from an average 18.3% of GDP in the 1974-1980 period to 20.1% in the 1981-2000 period (and to 22.5% in the 1999-2003 period); imports of goods and services rose respectively from 23.4% to 27.2% of GDP (and to 30.1% in the 1999-2003 period). In the 1990s the share of exports to the Balkans, to Central European countries and to the former USSR rose substantially, while the make-up of exports shifted somewhat towards high technology and/or new products. Finally, between 1983 and 2000 the share of employees (wage and salary earners) in total employment rose from 48.3% to 58.4%; their share in *non-agricultural* employment, however, rose only slightly -- from 67.2% to 69.6%.

4. Inside the euro area: the first three years (2001-2003) -- policy challenges under EMU -- the challenge of EU enlargement

At the moment of euro area entry, Greece had been on the path of *real* convergence for five years already (1996-2000); it has *remained* on this path for the three years that followed (2001-2003). During this eight-year period, Greek GDP has been rising faster than the GDP in the EU or in the euro area. However, per capita GDP was equal to only 64.7% of the EU average (measured in "purchasing power standards") in 1995 and has risen to 68.3% in 2003.[26] Thus, the favorable growth differential currently observed is not wide enough to make full real convergence possible fast enough. Also, since Greek unemployment is still high (around 9%), current growth rates are not sufficient to achieve anything close to full employment within a reasonable period of time.

EMU membership has brought novel challenges. Some key national policy instruments (i.e. interest rate policy and exchange rate policy) are no longer available. Obviously, this means that the importance of fiscal policy, structural policy as well as of the attitudes and behavior of social partners (especially concerning

[26] Eurostat, *Structural Indicators,* updated November 12, 2003. Eurostat, however, cautions that measures in purchasing power standards (PPS) are "constructed primarily for spatial comparison and not for comparison over time"; Eurostat adds that revised figures will be published by the end of 2003.

price and wage increases) has grown -- both for dealing with asymmetric shocks and for maintaining and improving competitiveness. Thus, fiscal consolidation and structural reform have to be speeded up.

The 2004 enlargement of the EU adds to these challenges. Greece, Portugal, Spain and Ireland will lose their current "most-favored" status with respect to EU structural funds. It is obvious that the new member countries will be net recipients of funds, and that both the CAP and the structural policies will be revised, as it is already happening. Greece, who is a net recipient of funds today, will probably continue to be one, but net inflows will be reduced.[27] The time profile of the transfers, as well as the size of their reduction, *inter alia* will depend on Greece's differential growth rate, on the changes that will be made to CAP and to the EU's structural policies, and on the transitional arrangements that will be agreed for both old and new members.[28]

The effects that the reduction in net transfers will have on the growth rate of the Greek economy will depend on: (a) the contribution that these transfers have made to the productive capacity of the economy up to now; (b) the effectiveness with which currently incoming transfers are utilized;[29] (c) the extent to which the Greek economy will manage to face up to more intense competition in the enlarged EU market means and also take advantage of the greater opportunities that it provides.[30]

In the years to come, the major goal of economic policy for Greece will be to achieve full real convergence as soon as possible. *However, this presupposes that nominal convergence, i.e. stability of public finances and price stability, will be safeguarded*. Thus, more measures are needed to complete fiscal consolidation (i.e. reduce the debt-to-GDP ratio from approximately 102% today to close to 60%), as well as increase productivity and competitiveness. This implies a need for:

[27] According to studies by DIW ((Deutsches Institut für Wirtschaftsforschung) which include alternative scenarios concerning the allocation and the size of Community funds in 2007 and in 2013, the reduction in per capita net transfers to Greece in comparison to the 1995-99 average ranges between 3.1% and 17.5% for 2007 and between 27.9% and 46.5% in 2013, depending on the assumptions concerning Community policies. See: Weise, C., "EU Eastern Enlargement Can Be Financed – Increased Need for Reforms – Scenarios for the 2007 and 2013 EU Budgets", DIW, *Economic Bulletin*, 10/2001.

[28] Bank of Greece, *Annual Report 2002*, 2003, Box IX.2.

[29] An interesting point in this respect is made by Heather Grabbe (research director of the Centre for European Reform) in a *Financial Times* article ("A better way of helping eastern Europe", October 25, 2002) addressed to the Accession countries: it is best to use EU transfers to invest in education and training and to reform healthcare systems, rather than to support failing industries.

[30] Bank of Greece, *Annual Report 2001*, 2002, p. 47-48.

-- Restructuring the general government sector, effectively controlling primary expenditure and completing the tax reform; it will thus become possible to generate new public revenues and also to shift public funds away from interest payments and "traditional" items of current expenditure, so that they can be used to support employment and entrepreneurship, match or eventually replace EU funds for structural intervention, and help face the financial burden of an ageing population, i.e. future pension liabilities;

-- Increasing labor market flexibility, putting in place incentives to stimulate labor supply, improving information and matching of supply and demand in the labor market, overhauling the system of training and education;

-- Attracting large inflows of foreign direct investment (they are very low today, no more than 1% of GDP), both by simplifying regulations on foreign investment, mergers and acquisitions, and startups and by strengthening competition and opening up sectors.

In conclusion, achieving full real convergence necessitates a concerted and sustained effort, i.e., first, mutually supporting policies which inspire confidence both to domestic economic agents and to foreign participants in the markets and, second, social consensus. This is the main lesson for the future from Greece's recently concluded, successful effort for nominal convergence and from its achievement of steadily high real growth, higher than the EU average, which has placed the country on the path of real convergence for the last eight years.

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Contact information:
e-mail address: isampethai@bankofgreece.gr
