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Drakmens deltagelse i EMS: Mulige virkninger

Aufnahme der Drachme in das EWS: mögliche Auswirkungen

Η ένταξη της δραχμής στο ΕΝΣ: πιθανές επιπτώσεις

The drachma's adhesion to the EMS: possible effects

L'entrée de la drachme dans le SME: les effets éventuels

L'entrata della dracma nello SME: possibili ripercussioni

Het toetreden van de drachme tot het EMS: mogelijke gevolgen

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The drachma's adhesion to the EMS:

Possible effects

This study has been prepared by Dr. N. KYRIAZIS in reply to a request by Mr. J. Moreau, President of the Economic and Monetary Committee of the European Parliament for the forthcoming meeting of the Committee in Athens in June 1983.

It is hoped that this study will contribute to a better understanding of the monetary problems of the EC and Greece.

For technical reasons the study is available only in English, French and Greek, but in case of demand by members of the European Parliament it could also be translated into the other official languages.

Francis ROY
Director

The Drachma's Adhesion to the EMS: Possible Effects

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The Drachma's Adhesion to the EMS : Possible Effects^{*}

1. The European Monetary System: An evaluation for the first four years

An evaluation of the first four years of the EMS is necessary in order to answer the question of the drachma's adhesion to the EMS. Through this evaluation it can be seen if, and to what extent, the EMS achieved its aims and what would be the advantages and disadvantages for the Greek economy of the drachma's adhesion to the EMS⁽¹⁾.

The purpose of the EMS is to create European monetary stability, through the implementation of certain exchange rate, credit and resource transfer policies, backed up and guided by a new policy of coordination aimed at promoting the convergence of economic policies and performances⁽²⁾.

Thus, the EMS was conceived as an answer to existing international monetary instability and was a compromise solution between fixed (central rates of the EMS) and floating exchange rates (margins of fluctuation around the central rates). The fixed element in the EMS resulted from dissatisfaction with the experience of floating (or managed floating) after the breakdown of the Bretton Woods System. Contrary to expectations resulting from the monetarist theory that was the most important proponent of floating, floating rates have not simply proved to be no panacea, but their operation has disappointed reasonable expectations: Floating rates did not secure independence for domestic policy⁽³⁾. The flexible element in the EMS was introduced in order to ease temporary tensions within the system, thus avoiding the need for too frequent realignments of the central rates.

*

I would like to thank Prof. Dr. G. Demopoulos, currently economic advisor at the European Commission, for his valuable comments on the preparation of this study, as well as Dr. K. Revelas, Mr. Th. Papaspyrou and Mr. G. Floros of the European Commission for many stimulating discussions. I am responsible for any remaining errors.

The following solutions were possible for the EMS:

- (1) The introduction of a new currency created ex nihilo and which would form a kind of screen between national currencies and third countries' currencies. This new currency would be created independently from the national currencies. Various proposals have been put forward as to the form this currency would take, among them a proposal to introduce the ECU with a stability guarantee. (i.e. the price level of a representative commodity basket would be kept constant in terms of ECU's).
- (2) The introduction of a currency formed as a basket from the existing national currencies of the Member States. This currency is not created independently but depends on the reserves (dollar and gold) of the Member States. Its "value" is dependent on the "values" of the currencies concerned⁽⁴⁾.

For political reasons the second solution was chosen.

An evaluation can be undertaken through a comparison of the aims and results achieved⁽⁵⁾. We can distinguish two main aims: 1. Monetary stability: This comprises an internal (prices and interest rates) and an external element (exchange rates); 2. Convergence, which can be measured by the development of various economic indicators, like the GNP, employment-unemployment rates. As can be seen from tables 1 and 2, inflation was very uneven in the EC Member States. Price differentials within the EC are today wider than those recorded on average during the period 1974-1978, following the first oil price shock. In 1982, taking only the Member States effectively participating in the EMS exchange rate mechanism, there was a difference of 15.4% (price deflator of GDP at market prices) between the country with the lowest inflation, Germany, and the country in which inflation was highest, Ireland. The inflation rate in France is more than twice (12.4%) and in Italy more than three times (17.5%) the rate of Germany (4.8%). Thus it can be seen that up till now the EMS has not been successful in achieving greater monetary stability and reducing inflation rates.

As can be seen from tables 3 and 4, interest rates showed also differences, both concerning short-term, as well as long-term interest rates,

although the differences were not so marked, varying in 1981 from 10.4% (long-term interest rates) in Germany to 20.6% in Italy. The same was also true for short-term interest rates, although the differences here were even smaller. (From 12.4% in Germany to 19.0% in Italy).

The relative failure of the EMS to achieve more monetary stability must be seen in the context of the short observation period (only four years) and is also due in part to adverse external conditions, such as the economic recession and the second oil shock of 1979. There is the problem of the isolation of factors influencing monetary development in the Member States. Also, it is well known that in a situation of rising inflation rates, as existed up to 1982, divergences in inflation rates between countries tend to be accentuated. These differences might have been even more pronounced in the absence of the EMS.

Towards the end of 1982 and beginning of 1983, inflation rates decelerated in all Member States. If this trend continues, then a greater monetary stability and convergence can be achieved in the future.

Concerning the external element of monetary stability, the exchange rates, the EMS was more successful. Although beyond a certain threshold the divergences in inflation rates will have an impact on the nominal exchange rates of the EMS currencies, necessitating the realignment of the central rates, there has been a reduction in the very short-term variability of exchange rates between the currencies participating in the EMS, including the Italian lira. On the other hand, the exchange rates of non-participating currencies have remained highly volatile and this short-term instability has been part of very large long-term fluctuations⁽⁶⁾.

The fall in effective rates in countries such as France, Italy and Ireland, which have experienced more rapid inflation than the other countries, has been contained within narrower limits during the period of operation of the EMS than the previous period, as can be seen from Table 5b.

The adjustments in central rates have only partly compensated for the movement in relative costs and prices. This has resulted in a gradual real

appreciation of these currencies, in particular the Irish pound, (as can be seen from Table 6).

The establishment of the EMS has thus put an end to the phenomena of overadjustment previously observed and has made for a return to more normal conditions.

It may be concluded that concerning the external element of monetary stability, i.e. exchange rate stability, the EMS has succeeded in reestablishing a more orderly structure of exchange rates between participants and in reducing volatility and this despite the instability of the international monetary environment, the disruptions caused by the second oil shock and persistent divergences in nominal variables. But, as the Commission remarks; "This achievement, the fruit of an initial phase during which order was restored, will be seriously compromised if greater convergence in economic policies is not established. Greater exchange rate stability requires more moderate and more closely aligned growth of nominal variables, and this achievement cannot without damage be put off any longer. Failing this, the EMS would change in nature and become something similar to a crawling peg system of parities."⁽⁷⁾

Exchange rate stability was not envisaged by the creators of the EMS as an objective in itself, but as a means toward and a result of the convergence of the Member countries' national economic performances towards internal stability, although exchange rate stability is a desirable goal and it has helped to sustain business and trade among the EMS members. With respect to convergence, the EMS has not produced very satisfactory results. As mentioned above, the inflation rates diverged strongly, contrary to expectations. In a system like the EMS it was expected that a country whose costs and prices would diverge upwards from its partner's average, would gradually lose its competitiveness and experience a downward pressure on its currency, would, under the EMS mechanism, adopt a stricter monetary policy to defend its exchange rate. This would, at the same time, help to stabilize its costs and prices. Thus, under normal circumstances, the exchange rate mechanism and the instruments associated with it would have helped to bring about a greater convergence of inflation rates ⁽⁸⁾.

In fact this did not happen, because the Member States with high inflation preferred not to follow restrictive policies, but to devalue their currencies through a realignment of their central rates. They chose not to use the financial mechanisms of the EMS, some of which are coupled with policy measures to be undertaken by the borrowing country, but to resort instead to market borrowing ⁽⁹⁾.

Due to the short observation period and adverse international economic situation, it is very difficult to evaluate the effects of the EMS on the convergence of real variables. Measured by GDP per head in ECU's, the absolute gap between the richest (in 1978 Denmark and in 1982 Germany) and the poorest EMS member (in both years Ireland) remained about the same, but the relative difference was reduced from about 2.9 to 1, to about 2.1 to 1. Again, it is impossible to isolate the effect of the EMS upon this trend because the EMS influences real growth in a roundabout way, i.e. through the promotion of trade, and amelioration of capital flows.

The EMS introduced the following new elements which distinguishes it from its predecessors: 1. The divergence indicator; 2. An increase in the credit mechanisms; 3. The possibility of wider fluctuation margins for weaker currencies like the Italian lira; 4. Coordination and common accord for the realignments of participating currencies; 5. The existence of central rates. These new elements were expected to guarantee the smooth working of the EMS.

The main importance of the divergence indicator is that it represents for the first time in Community and world monetary history an agreement on the use of an objective indicator as a trigger for policy coordination ⁽¹⁰⁾. The indicator is asymmetric in its working, as Vaubel has shown ⁽¹¹⁾. An indicator that results in the adaptation towards an average, without an indication as to whether the national inflation rate is higher or lower than the average, is inadequate to combat inflation. The warning signal of the indicator does not function when two currencies with a small weight move towards their respective intervention points, while the other currencies remain near the middle of the two extreme currencies. The two extreme currencies then reach their intervention points without having passed their threshold of divergence ⁽¹²⁾.

Also, although the divergence indicator is an indicator for undertaking policy measures, there is no compulsion for the Member State or States whose currency diverges to undertake such measures. Still, in practice, the Member States did intervene in such cases, although the time-lag between the signal and the intervention was sometimes quite lengthy.

Vaubel also criticises the fact that although the divergence indicator works as a presumption to undertake policy measures, the Member State, whose currency deviates, can choose its own measures in freedom, since there are no agreed measures that must be undertaken. It can choose either monetary policy measures or an adaptation of the exchange rate.

If one country uses the financial facilities of the EMS, it could try to reduce its financial burden after borrowing, by devaluating its own currency. This would reduce the ECU-value of the credit, since the national currency is participating in the ECU. (A devaluation of the national currency devalues also the ECU, to a lesser extent). This is an inflationary element in the system.

Also, the EMS has an inflationary bias for the following reasons: "Interventions according to the rules of the parity grid always require net money creation in the surplus country while there is no corresponding contraction of the money supply in the deficit countries, apart from the primary effect of sterilizing those sums of the deficit currencies bought with the surplus currencies by way of intervention. This primary deflationary effect can easily be compensated by reflationary measures of the monetary authorities in the deficit countries.

It is improbable that the surplus countries can react by compensatory deflation. Furthermore, the large facilities of the EMS can be used to borrow from the surplus countries of the EMS and at the same time to inflate them. If the so-called divergence indicator is used to put pressure on the surplus countries this might sometimes lead to more inflation in the surplus

countries instead of revaluation, which is always a political decision against one's own export and import competing industries. In Germany it is not the central bank, but the government, which is responsible for changing a parity. Thus, new exchange rates are fixed by a political institution, which is extremely exposed to economic pressure groups. Consequently currencies are, as a rule, revalued too late and by too little, leading to more inflation.

In the EMS there is not the slightest element of an automatic adaptation to the stability standard of the most stable currency. All regulations work in the opposite direction. If the DM should incidentally be the most stable currency, the chances are high, that instead of educating the others it will lose some of its traditional strength. The only hope left for German policy is the autonomous decision of the other member countries to stabilise their currencies in their own interest."⁽¹³⁾

The passage quoted above expresses well the strongly stability-minded German reservations on the EMS. These fears proved to be exaggerated. It cannot be shown that the EMS helped to accelerate inflation. The credit facilities of the EMS are not inflationary because while they do create money in the surplus country, they also reduce money supply in the deficit country, not only through the intervention of the central bank but also through capital outflow in the expectation of devaluation by the weaker country. Furthermore, medium-term financial assistance is conditional and requires that the borrowing country undertake measures of monetary discipline. This has been the reason why the deficit EMS countries preferred not to make use of this facility but to resort to market borrowing at a higher cost. It can be said that if the members of the EMS made use of the credit facilities, this would result in more, not less, monetary discipline and less inflation in the higher inflation countries

Moreover, the use of the divergence indicator has apparently not produced more inflation in Germany, since the German government chose to revalue whenever the danger of imported inflation appeared. Also, due to the fact that the decision to appreciate or devalue is a decision of the government and because any devaluation is seen negatively by the public opinion of the devaluing country, the governments do lie under a "moral" constraint not to devalue too often and to try to pursue more stability oriented monetary policies.

This seemed to be the case during the last realignment of March 1983, where the French and Italian governments tried to keep devaluation within narrow limits. In fact, the French government undertook a more restrictive economic policy after the devaluation.

Although the criticism that the EMS credit mechanism can have some inflationary consequences is valid, this logical observation seems to be of questionable relevance in the current environment and insofar as countries share the common objective of reducing their rates of inflation. Because governments have a common objective, the EMS has proven to be stable as an institution and it is a measure of its success that no participant country has chosen to withdraw. A country that withdraws has no immediate set of arrangements that it can adopt. It can only move back to a system of managed flexibility, in partial reaction to which it decided to join the EMS. The absence of any intermediate alternatives provides an incentive for participating countries to pursue monetary policies which are not inconsistent with the survival of the EMS." (14)

A further criticism of the EMS concerns the ECU as a basket currency, if it is intended to be a starting point for a common European currency. Such an ECU, if allowed to circulate as an exchange medium among private persons or commercial banks of the Member States, could substitute the weak and most inflationary currencies, but it could not substitute the strong currencies, since these will always be stronger than the ECU, which contains weak currency ingredients as well. So, the ECU is inadequate for the future task of realising a common European currency (15).

An advantage, but also a condition for the further functioning of the EMS, is the need to closely coordinate national monetary policies. Shortly after its introduction, Thygesen remarked: "The EMS, if it is to have any significance, must imply above all a willingness to make exchange rate policy increasingly a matter of joint decision and to use that policy instrument less than in the past. The policy coordination triggered by the divergence indicator will not typically point to an exchange-rate adjustment as the first line of defense, but to domestic instruments for stabilisation." (16)

The coordination of monetary policies met, in fact, with mixed success: Exchange rate policy, as realised during the seven realignments of the EMS central rates, was a matter of joint decision, but on the other hand, the policy coordination, triggered by the divergence indicator, had as a consequence the adjustment of exchange-rates and not the use of domestic instruments for stabilisation, at least in cases where this would require a change in economic policy.

This may be due to the lack of any formal decisions and guidelines for policy action. Such guidelines should be informative to the participating countries in setting the limits of accommodation to differences in behaviour, in particular with respect to inflation rates. They should be sufficiently clear to be interpreted by private-market participants in such a way that expectations in the market support, rather than counteract, the efforts of the authorities. "Encouraging caution in the divergent countries by not giving them the right, but only a possibility, to adjust their central rates, should typically yield greater stability in the EMS rate structure and more rapid policy convergence than to set up apparently firm rates which will anyway have to be interpreted with flexibility."⁽¹⁷⁾

A serious omission of the EMS is the lack of a common policy towards third countries and in particular the dollar. The EMS agreement provided also for coordination of exchange-rate policies vis-à-vis third countries and as far as possible a concertation with the monetary authorities of these countries, but this has been neglected. It can be argued that to some extent it is in fact the German Bundesbank that dictates the common policy towards the dollar, because the DM is the key currency in the EMS. The other EMS currencies' position towards the dollar is determined either by the inaction or by the concerted interventions of the Bundesbank and the Federal Reserve. When the dollar weakens, so that short-term capital takes refuge in the DM, tensions between the DM and other EMS currencies tend to appear. These speculative flows of capital, originating outside the EMS, induce strong currency countries within the system, like Germany, to intervene in order to prevent appreciations of their currencies beyond the fluctuation margins of the EMS. A concern that

was often expressed in Germany, was that such interventions would lead the Bundesbank to expand the monetary base beyond what seemed to the German monetary authorities to be compatible with internal stability.

In fact the volume of those interventions was never such as to prevent the objectives of internal monetary growth from being achieved in the intervening countries, especially since the Bundesbank used sterilization policies successfully.

Still, policy coordination towards the dollar and other countries is desirable ⁽¹⁸⁾. This could be achieved directly or indirectly. Indirectly, if other EMS currencies were equally attractive from the point of view of their financial stability, international investors would spread their short-term assets more equally over these currencies and occasional flights from or to the dollar would not be so massively concentrated on the DM. It follows that in the long-run a better convergence of economic performances within the Community might be conducive to a more balanced common policy towards the dollar.

Directly, a coordination of policies vis-à-vis the dollar can be also pursued. J. van Ypersele has proposed to replace part or all of the existing bilateral swap agreements by a FECOM-Federal Reserve swap credit line, to be used so as to stabilize the exchange market within the EMS instead of creating tensions, to the extent that the currency used by the FED for reimbursing the FECOM need not be the same as the one borrowed for intervention ⁽¹⁹⁾.

2. The Greek economy: Recent developments and economic policy

As happened with all Member States, Greece's economy was hit hard by the international recession which accentuated the existing structural and regional disequilibria⁽²⁰⁾. The problem of adjusting the economy to its environment is mainly a structural one, because no long-term improvement in production and competitiveness is possible without a long and systematic effort to increase domestic supply, which involves restoring high investment ratios. This must be combined with vigorous measures to combat inflation, which presently distorts the allocation of production factors and so inevitably hampers structural change.

The policy measures of the present government try to achieve these two aims. These measures will be further specified in the five-year plan, now in preparation. By combining a large increase in the lowest incomes, early in 1982, with price controls on necessities and a major selective increase in taxation, this policy aims to stimulate consumer demand while slowing down price increases. An indexation system of adapting incomes and pensions has been introduced. Furthermore, another aim of the policy is to reduce aggregate domestic credit as a proportion of GDP, by vigorously restraining the expanding trend of the public sector deficit. Lastly, the policy aims at encouraging the recovery of investment through a selective credit policy which has succeeded in keeping real interest rates at a very low level, and by completing the system of a very varied range of sectoral and regional aids.

The international economic crisis is a constraint that limits the government's freedom in economic policy. Greek competitiveness, based on unit labour cost, decreased by 17.5% as against Greece's 19 most important commercial partners and by 26% as against the EC during the last two years. In the two years since joining the EEC, Greece's trade deficit with its EC partners has doubled to \$ 2.5 billion, while its overall trade deficit in the first ten months of 1982, was \$ 4.9 billion. This was due in part to the structural weakness of the Greek economy and in part to increased demand due to the higher incomes of the lower income groups after the introduction of indexation. An important part of this additional demand could not be satisfied by domestic production and had to be covered by imports. Also, Greek industry was used to a climate of high

protection in the form of customs duties so that it suffered through increased EC competition after the reduction of custom duties, following accession.

Exports have stagnated so far, due to the loss in competitiveness and investment has shown no signs of picking up. Moreover, it has proved impossible to reduce liquidity because the public sector deficit could not be restrained, as far as was hoped. The real growth rate was negative in 1981 (-0.7%) and is estimated at 0.7% for 1982 and 1.9% for 1983⁽²¹⁾.

Faced with this situation, the government had to take some drastic and, to a certain degree, unpopular, but necessary, measures. The first was the depreciation of the drachma by 15,5% in January 1983, in an effort to restore the equilibrium of the balance of payments and to offset the effect of inflation differentials on Greece's competitiveness. The second was the introduction of a more restrictive policy through the postponement of any increase in wages and salaries for 1983. During 1983, no increases in wages and salaries will be given, which means that available real incomes will decrease, taking into account an anticipated rate of inflation of about 20%. This form of incomes policy is expected to have two effects: on the supply side it will reduce cost and so increase the competitiveness of Greek products and on the demand side it will reduce demand and therefore also imports, helping the balance of payments. A further measure was the introduction of import restrictions for some products which will be kept at their 1982 levels, in order to protect domestic production of some hard-hit sectors.

The Commission proposed the following policy lines for Greece⁽²²⁾: The present tight policy should be continued because it is essential to control inflation if the financial conditions are to be established, to allow the major investment effort required for the transformation of the economic structure. Policy measures should try to ensure that nominal trends begin to slow down in 1983. Also, efforts to restrain the rise in incomes (i.e. incomes policies) must continue. In applying the index-linking mechanism, the disadvantages of excessively narrowing the overall range of

wages and salaries should be avoided.

Price controls must also be continued in order to prevent excessive price increases that accelerate inflation. The liquidity ratio in the economy must be further reduced by bringing the net public sector borrowing requirement to below 10% of GDP through cuts in current expenditure and increases in public service charges, by tightening credit controls and by encouraging stable savings. To achieve the last aim, interest rates can no longer be kept at an artificially low real level and more account will have to be taken of market conditions when fixing interest rates.

In particular areas, the following developments took place: The central government budget deficit (including government trading accounts) was virtually stable up to 1981, at around 5-6% of GDP. In 1981 the deficit doubled, increasing to 12% of GDP. This resulted in an acceleration of inflation, reaching a post-war peak of 24.4%. (Private consumption price deflator). The new socialist government prepared the 1982 budget with the aim of reducing the deficit to 9% of GDP. This budget (adopted by Parliament in April 1982) provided for a substantial increase in revenue (about 58,5%) to come from the following sources: 1. Indirect taxation, via new taxes and the increase in existing ones; 2. Direct taxation, via new taxes and the diminution of tax evasion; 3. The European Agricultural Guidance and Guarantee Fund. On the other hand, the increase in expenditure was estimated at 35%, resulting, according to the Commission's estimates, in a general government requirement equivalent to 9.2% of GDP in 1982, as against 10.1% in 1981.

With regard to the labour market, in the past, the low official rate of unemployment (which concealed substantial underemployment, in particular in agriculture), was used as an argument for not undertaking specific employment measures. The new government (due in part also to rising unemployment in Greece, estimated at 7-8% in 1982), announced a series of measures designed to improve the operation of the Labour Administration,

as well as the improved collection of statistics. The first economic policy package was introduced at the end of 1981, and included a reduction of the legal working week to 41 hours and the introduction of four weeks' paid holiday for everyone. In May 1982 it promulgated the instrument entitling private sector workers to 24 working days' holiday per year.

Further, the Commission has given a positive answer to Greece's memorandum concerning some special problems facing the Greek economy after the adhesion⁽²³⁾.

3. The drachma's adhesion to the EMS

3.1. Greek monetary policy

The Greek Banking System consists of: 1) The central bank (Bank of Greece); 2) 22 commercial banks, 10 of which are Greek and 12 foreign; 3) 3 investment banks (The Hellenic Industrial Development Bank, which is a state-owned institution, The Investment Bank and The National Investment Bank for Industrial Development, which are private banks); 4) 5 specialised credit institutions.

Non-banking institutions do not play an important role in financing investments mainly due to underdeveloped capital market, so that the banking system is the most important institutionalised market in mobilising and allocating private and public financial resources.

Until 1982 the economic policies to be followed were determined by the Currency Committee, which was abolished by the new government in 1982 and was replaced by the Council of competent ministers, or by the minister of National Economy alone.

Before 1982 the Bank of Greece was responsible only for the implementation of the monetary and credit policies and the preservation of the country's monetary stability. But due to the structure of the Greek economy, the existing institutional framework exerted high pressure on the Bank of Greece to increase the monetary aggregates, such as the money supply, at rates that endangered the aims of economic development and stabilisation. Monetary policy was implemented in the form of a credit policy aimed towards the availability of credit for purposes of economic development. This was done through a complex system of secondary reserves for different credit lines⁽²⁴⁾. Further, money supply and the monetary base responded to changes in the stock of Treasury bills, so that the monetary base lost its quality as a policy variable in the hands of the monetary authorities, who thus became subservient to budgetary policy. This also contradicted the monetary authorities' policy in affecting aggregate demand by controlling the money supply in order to attain price stability or to prevent price level accelerations.

The controls over the availability of credit, coupled with artificially low (and negative) interest rates⁽²⁵⁾ produce perverse effects on the desired objectives of economic development and stabilisation, because this policy:

- (1) eliminates competition and leads to an ineffective allocation of resources⁽²⁶⁾;
- (2) favours large establishments at the expense of small and medium-size establishments thus making them less efficient;
- (3) reduces the self-financing of all establishments and thus places the burden on the credit institutions;
- (4) establishes low rates of return and consequently a low-risk investment behaviour on behalf of the banking system. This investment behaviour obviously leads banks to discriminate against less wealthy economic units. Hence, the argument that low interest rates on bank credit help the less wealthy economic units, thus maximizing the social welfare, is questionable. Furthermore, as long as credit is rationed by price, everyone has access to it at a price, but once it is rationed in other ways access depends on meeting certain quality criteria (such as good balance sheet ratios) and on nepotism, personal contacts, etc. These things do not help the small firms or the poor;
- (5) keeps interest rates probably well below the levels actually determined by demand and supply conditions and thus it enhances the inflationary pressures;
- (6) requires an effective administration to check the good use of credit. This is very difficult to be accomplished;
- (7) presupposes that the central bank's discount rate determines the interest rates on bank credit. That is, the discount rate is taken as a proxy for the banks' credit cost. This may reduce the importance of the discount rate as a relevant monetary policy tool;
- (8) makes interest rates on bank credit an ineffective opportunity cost, since banks are not allowed to extend loans unless there is an increase in their private deposits;
- (9) assumes that monetary policy actions are generated through controlling the bank credit. That is, monetary policy is implemented in the form of a credit policy.⁽²⁷⁾

Many European and other countries have at various times undertaken an administrative approach to monetary policy but large scale economic models constructed to analyse the impact of policy in various countries show no superiority of quantitative credit regulation over market-oriented methods. No country had succeeded in developing a design of direct control of lending, combining effective control of aggregate credit flows with the changes in market shares and in specialisation which are typically associated with a competitive banking sector. Also, these methods were gradually losing their impact as financial institutions and their customers found ways around the restrictions. Competition was not inactive, but it took forms that appeared detrimental to the institutions affected by the regulations⁽²⁸⁾.

The new government reformed the institutional framework by introducing a limit of 7% of the advances given by the Bank of Greece as a percentage of each year's budget. This will reduce the inflationary pressure that emanated from the Bank of Greece's increase of money supply in order to cover budget deficits. Further credit needs of the public budget will be covered by interest bearing state obligations, that can be discounted within limits at the Central Bank. The complexity of the credit system was reduced by the introduction of a simplified system of credit allocation⁽²⁹⁾.

For the time being, the drachma's exchange rate, vis-à-vis various foreign currencies, is set by a "governmental decision" by the Bank of Greece, according to a basket of currencies. The weight of each currency in the basket is given by the relative importance of each country as a commercial partner for Greece. Among them the most important are the dollar, (due to the fact that the dollar is the base for tourism, payments of the oil bills and receipts from the merchant navy), the DM, the FF, the Italian Lira and the other European currencies. Since Greece's admission, the drachma has been introduced to the Paris exchange market but the quantities handled there are small and do not really influence the exchange rates set up by the Bank of Greece⁽³⁰⁾.

As in most economies, inflation in Greece has an external and an internal component. The external component is due to the price increases of imports, either due to an absolute increase (as happened with the oil prices up to 1979 and other raw materials) or to an increase in the equivalent

in drachma, due to a devaluation of the exchange rate of the drachma. The internal component depends on such factors as the financing of the budget deficit, wage developments, the development of the money supply (related to the public deficit, as noted above) and structural disequilibria. The structural element, that mirrors the disequilibria of the Greek economy, like monopoly elements, an important intermediate sector from production to consumption, a possibly important "shadow" economy, speculative elements etc., has been stressed often as accounting for an important part of the inflation, although empirical evidence as to the relative importance of each element for inflation is lacking⁽³¹⁾.

Former Greek governments, although declaring that they gave great importance to the aim of stability and monetary stability, seemed in fact to neglect this aim. In reality the aim of stability came quite low in the hierarchy of economic aims. The result was high and increasing rates of inflation. The failure of stabilisation was due both to the subordination of this aim to others and also to the lack of a coherent long term economic and monetary policy, which had been replaced by ad hoc measures to counter particularly urgent problems. These ad hoc and uncoordinated measures aggravated in the long term the instability of the Greek economy.

The advantages of stability (and the disadvantages of inflation) are well known: amelioration of trade and the internal transactions, better programming at every level, less uncertainty and risk etc.

In the next sections some economic policy options that could be raised against the participation to the EMS, are examined and criticised. The main conclusion is that the stabilisation of the Greek economy, upon which the new Government has embarked, is necessary and that the adhesion to the EMS can be an element in a stabilisation policy. Further, the possible cost of the adhesion is examined and some accompanying policy measures are discussed.

3.2 The trade off between unemployment and inflation

Adhesion to the EMS, with its fixed (but adjustable) exchange rate element, the central rates, means abandoning flexible exchange rates (or managed floating as in the Greek case). This would entail the loss of independence in the shaping of monetary policy and a constraint in economic policy in general. This would have negative influences on the fight against unemployment and the competitiveness of Greek products and related to this, would influence adversely the balance of payments⁽³²⁾.

The argument that the independence of monetary and economic policy is necessary in order to reduce unemployment, is based on the existence of a trade-off between unemployment and monetary expansion or the inflation rate. This is the well known Phillips relation. If a country follows a policy that permits it to keep a certain exchange rate parity, as would be the case if Greece joined the EMS, then this country would no longer be able to reduce unemployment through an expansionist monetary and fiscal policy. This argument is correct insofar as the Phillips relation is valid.

But empirical evidence as well as theoretic considerations, point out that the Phillips relation is no longer valid. It was based on a certain degree of money illusion and considerable lags in the adaptation of expectations to changes in money supply. Even if one does not accept the extreme case of rational expectations, it is certain that expectations now adapt much faster than two decades ago, when the Phillips relation seemed to be valid. In the long term, an increase in inflation does not change employment. A short term unexpected increase in inflation could reduce, but not permanently, unemployment. But the social cost of this would be high, since the economic units adapt by using resources, among them also working time, so that these resources are no longer available for other uses. The adaptation results in a waste of resources. Further, in order to have permanent effects, such a policy would lead to higher and higher inflation, since the relevant issue is not a high rate of inflation, but an increase in the rate of inflation⁽³³⁾. Also, for the same reasons the exchange rate cannot be used to lower real wages, in order to increase competitiveness, if real wages are deemed to be too high. The existence of high inflation and high unemployment at the same time points to the non validity of the Phillips curve. At the same time, countries with low inflation also had low unemployment as for example Germany and even more so Switzerland. In the 1970s there seemed to exist a perverted

Phillips curve, combining high unemployment with high inflation⁽³⁴⁾.

Greece seems to be no exception to this, since during the last years accelerating inflation was accompanied by rising unemployment.

It is also argued that under flexible exchange rates a country can choose with greater freedom its economic policy, it can follow an expansionary path that would not be possible under fixed exchange rates, since this would result in a devaluation.

But, also under flexible exchange rates, it is by no means certain that expansionary measures can have the desired effect on real variables, like output and employment. Expanding aggregate demand spills over into the foreign sector, putting immediate downward pressure on the exchange rate. Since the foreign exchange market is the archetypical "flex-price" market, such pressure will immediately be converted into a depreciating exchange rate, raising import prices and hence raising money wages and inflation. Under flexible exchange rates, the price for expanding domestic income and employment, if at all successful, is unacceptably high in terms of inflation. A practical example of the unfeasibility of unilateral expansion was France, who tried to expand unilaterally under the new government in 1981. This resulted in higher inflation and devaluation of the FF, without important effects on output and employment. The French government recognised the failure of this policy and reversed it⁽³⁵⁾. The possibility of unilateral economic policy measures are even less feasible for a small open economy like Greece. The autonomy of economic policy is constrained by the size and the openness of the economy, independently of fixed or flexible exchange rates.

An additional criticism of monetary policy measures, which try to influence real demand is that: 1) The time-lags with which changes in monetary instruments have an impact on spending decisions are both long and variable; 2) The monetary authorities cannot use their control over nominal quantities to peg a real quantity such as the real interest, the rate of unemployment, real income or the real exchange rate⁽³⁶⁾; 3) According to the monetarists it is advisable to select in each country, according to its institutional circumstances, some concept of the money supply, as the prime target and to stick to a low and steady rate of expansion of this aggregate.

In particular, the disadvantages of monetary measures are that although their short run effects can be significant, the gradual build-up over a long period of the effects of monetary policy puts the monetary authorities in a dilemma. If some monetary measure is designed with a view to take effect for example within a one-year horizon, it is unlikely that the additional effects will fit well into the desired macroeconomic pattern for the following years. They may have to be at least in part neutralised by measures in the opposite direction. Thus, the consequence of the extended time pattern of the responses to monetary actions is to impose a notable instability upon the monetary actions themselves. Such fluctuations may be so upsetting to the financial markets and thereby to the prospects of achieving the desired impact on real demand that they are not worth having⁽³⁷⁾.

Under flexible exchange rates an expansionary monetary policy will lead to a devaluation. This again will lead through rising import prices and consequently of rising nominal wages, to an increase in inflation, triggering thus a vicious circle of devaluation and inflation. Many European countries, Greece among them, suffered from this.

In the late 1960s, flexible exchange rates had been advocated as a system that would contribute to national economic sovereignty by removing the balance of payments constraints. But for the 1970's they did not operate that way, because, while they allowed for vast differences in inflation rates, the external constraint, especially for weaker countries, appeared actually to increase. The floating exchange rates, while not solving the balance of payments constraint, transmitted fully the shock of external disturbances (like the oil shocks) to domestic inflation. Given the already existing major difficulties of inflation control, the possibility of a fall in the exchange rate was a more frightening prospect than a balance of payments deficit under fixed exchange rates, since such deficits existed in any case also under flexible exchange rates. So, the idea that inflation control required at least the avoidance of permanent exchange rate falls, gained increasing ground. It was widely believed that Germany and Switzerland, but also Austria and the Netherlands, had actually gained from an appreciating exchange rate prompting a "virtuous" circle after the first oil crisis. This idea also made weaker

countries, like Italy and Ireland, join the EMS, where the fixed element predominates. The entry of Italy, Ireland and also France in the EMS, entailing to a certain degree the acceptance of the lead of Germany in the field of monetary policy, was seen as a commitment to inflation control in these countries⁽³⁸⁾.

3.3. The balance of payments and competitiveness

Another argument in favour of flexible exchange rates and not joining the EMS could be that under fixed exchange rates the balance of payments would deteriorate and that competitiveness would suffer.

The exchange rate can be considered in two parts, a "nominal" and a "real"⁽³⁹⁾. Concerns about the exchange rate can also be divided into a real and a nominal part. The "popular" economic commentary would like policies to deliver high competitiveness (low e), so as to "encourage domestic industry and exports" and zero inflation (stable P), implying a rising nominal exchange rate (S), if there is world inflation (if P_F rises). At the same time it is feared that these two aims are incompatible. It is often argued that monetary policies low enough to ensure relatively stable prices will necessarily cause low competitiveness. The mechanism is assumed to run as follows: tight money works by raising the nominal exchange rate, some of this rise shows up in a domestic price level lower than would otherwise have been, but some shows up in a higher real exchange rate because money wages will not fully drop due to the change in the nominal exchange rate. Those who are concerned about the competitiveness of the domestic industry advocate a low exchange rate, even if this means more inflation. It seems that previous Greek governments accepted this view, following an accommodating monetary policy and a continuous devaluation of the exchange rate to influence the domestic industry, to stimulate exports and to reduce the balance of payments deficits. This view is open to serious criticism.

First, it is ex ante not certain that a devaluation will have the desired effect on the balance of payments and this independently from the theory one ascribes to, since no theory maintains that the result will be under any conditions the desired one⁽⁴⁰⁾.

Secondly, the important element for competitiveness is the real and not the nominal exchange rate, but the real exchange rate depends, in the long-run, on real variables, like the differences in the supply characteristics of aggregate production at home and abroad, which result in differential rates of productivity growth in the respective traded goods sector.

At the time there is wide agreement that output (and so also exports) is not greatly affected, if at all, by predicted changes in the supply of money or the exchange rate. This is not to say that unexpected changes also have no effect. They can exert important, but temporary effects. An anticipated change in the exchange rate has no real effect, whether on competitiveness, real profits or employment, if all prices are fully flexible. An unexpected change in the exchange rate can produce large transitory wind-fall effects on profits and competitiveness, as well as on output and employment in the traded industries. If wage rates remain locked in units of domestic currency and firms are in full competitive equilibrium, the rise in profits and employment in tradable industries that will follow a devaluation is permanent. The important element in the outcome of a devaluation is the response of money wages. Again, the characteristics and the existence or not of a "normal" Phillips curve are decisive. If expectations of inflation are formed rationally, new information is transmitted instantaneously and wage contracts are continually renegotiated (this means that the Phillips curve is vertical, non "normal"), then the effect of a devaluation is insignificant. If expectations of inflation are altered slowly, this will not be so, and devaluation will have an effect⁽⁴¹⁾.

Third, the existing empirical evidence supports the view that devaluation does not usually have the desired effect on the balance of payments. Current account positions seemed to react disappointingly slowly, if at all, to exchange rate changes, even when these were large and went consistently in one direction. The most notable examples were those of Germany, Switzerland and Japan. But among the deficit countries too, it was felt that both the UK and Italy were hardly helped by the steep depreciation of the pound and the lira, while the UK had later surpluses combined with appreciations (which were due primarily to the North Sea oil)⁽⁴²⁾. This can be explained in

part by the fact that the price, which is effected by the exchange rate is only one element of the competitiveness of one product, the qualitative, non price elements like quality, punctual delivery and after sales services being very important elements, in particular for high technology products.

The Greek experience also seems to support this view, because the steady devaluation of the drachma over a long period of time did not ameliorate the balance of payment situation. As can be seen from tables 8 and 9, while the drachma depreciated steadily towards the ECU (which can be taken as an average of the bilateral exchange rates with the nine currencies participating in it), there is no clear tendency in the development of the deficit of the current account of balance of payments.

Fourth, the above mentioned view does not take into account the influence of inflation and the connected devaluation expectation on the capital movements.

At present, the free movement of capital does not apply to Greece and even after its application this freedom is not absolute. Still, although Greece has relatively severe capital controls, there has been a constant and often illegal outflow of capital for speculative reasons, which was accentuated whenever a sharp devaluation of the drachma was expected. This outflow could possibly increase after the transition period if the inflation differences remain high, and the interest rates very low and even negative as they are now. If the monetary authorities continue their policy of maintaining fixed interest rates on deposits at low levels along with an underdeveloped domestic capital market and the presence of inflationary pressures, this will result in an increase in the already high demand for real estate together with an increased capital outflow. In both cases the result is unfavourable for domestic investment⁽⁴³⁾.

Capital flows depend on changes in the uncovered interest rate differential and changes in the expected rate of exchange rate change, e.g. appreciation or, in the case of the drachma, more likely devaluation. In Greece the high inflationary expectations coupled with the low interest rates resulted in an increased capital outflow, as mentioned above.

This would mean, that, as was the case with the other European countries, large capital flows acted as a buffer, offsetting in part the impact of internal monetary actions. Accelerations of domestic relative to foreign money creation tended to cause outflows matching a growing share of the initial expansionary action. Investors continuously reshuffle their portfolios by shifting out of assets denominated in currencies that are weak and into assets that are strong in terms of expected purchasing power. This results in a transmission of nominal to real variables: Inflation differences coupled with expectations and interest rates differences result in capital outflow from the weaker currencies, which influences negatively the capital account and so also the short run exchange rate, which is influenced primarily by the capital account situation. At the same time, domestic investment is reduced, resulting in negative effects on growth. One could speak again of a vicious circle⁽⁴⁴⁾.

The adhesion of the drachma to the EMS would have favourable effects on expectations, inflation and in strengthening the exchange rate of the drachma. This in turn would influence positively the capital outflow from Greece and so result in a further stabilisation of the exchange rate, reducing the external pressure on inflation. This again would reduce the need of intervention by the central bank in order to defend a certain exchange rate margin⁽⁴⁵⁾.

But the adhesion to the EMS would influence positively the inflow of capital to Greece due to the existence of Council Regulation No 1736/49, that provides that "Loans granted from its own resources by the European Investment Bank... and loans granted under Decision 78/870/EEC to aid investments in the less prosperous Member States may carry an interest subsidy (of 3% per year) financed by the budget of the European Communities, provided that these States effectively and fully participate in the mechanisms of the European Monetary System"⁽⁴⁶⁾.

Considering that investment and capital inflow depend on profit and that profit is a function of the interest rate, a decrease in the interest rate (through the subsidy) would increase capital inflow and investment. Italy and Ireland did exploit fully the possibilities given by this regulation.

3.4 Inflation tax and "tax-push" inflation.

Another explanation advanced to explain some governments' "preference" for inflation is that inflation profits them due to the "inflation tax" and secondly because it eases the bargaining process.

The "inflation tax" is due to the fact that due to inflation nominal incomes "jump" to higher income brackets where the tax coefficient is higher, so that the government's revenue is increasing without any new tax imposition. Also, inflation favours net borrowers and the state is usually a net borrower⁽⁴⁷⁾.

The view that the state did really profit from inflation was accepted till recently, when new empirical work, e.g. in the USA and Germany questioned this. According to these studies, inflation has resulted in higher total government expenses than revenues, so that the net public debt increased with inflation⁽⁴⁸⁾.

But even if the state profited from the existence of the "inflation tax" this would be due to an abuse of the state's monetary monopoly. In a democracy this should not be done and a greater transparency of the state's revenue is desirable. If a deceleration of inflation reduces the state's revenue, (without at the same time reducing even more the state's expenses, as recent empirical studies point out) then the hidden "inflation tax" should be replaced by an open increase of taxation, that should be visible to the tax payer.

The idea that has gained ground during the last decade is that, since no money illusion is valid any more, money wages are determined in a bargaining context which stresses after-tax real wages. This implies, contrary to conventional wisdom, that tax increases are inflationary while tax cuts may have the opposite effect. Thus governments concerned about the level of wage settlements could offer tax cuts in exchange for moderation in wage demands, ensuring so that real wage aspirations are satisfied at a lower level of wage settlements than would otherwise have occurred.

Under rapid inflation progressive taxes had the following repercussions: In countries relying on progressive systems of taxation the rapid increase in nominal wages under the impetus of sharply rising consumer prices led to unplanned increases in tax liability at given levels of real income⁽⁴⁹⁾.

The unplanned rise in existing high rates of direct taxation intensified industrial and political conflict, undermined fiscal control and made budgetary policy more erratic and less predictable. The unforeseen rise in direct tax liability intensified cost pressures, making it more difficult to bring down the rate of inflation (due to a wage-cost push type of inflation). Additionally, the effect of progressive tax scales in reducing differentials between skilled and unskilled and blue and white-collar workers and also between recipients of untaxed unemployment and welfare benefits became decisive issues in industrial relations and national politics. On the other hand, the existence of direct tax-push inflation is controversial and is a notoriously difficult area where empirical evidence is still unsatisfactory⁽⁵⁰⁾.

3.5 Related policy measures

In the preceding paragraphs some aspects of the flexible exchange rates and the relation to inflation were examined and criticised.

In concluding, relative exchange rate stability offers the following advantages to a small open economy like that of Greece:

1. The smaller economy tends to produce a less diversified range of output with a relatively large concentration of traded goods. External shocks have a larger impact on the small, undiversified economy than on a bigger country with an important internal market. Relative exchange rate stability facilitates trade by reducing the risk due to the fluctuation of exchange rates.
2. A small economy with its modest currency faces a higher probability that collusive behaviour among speculators will alter the value of the exchange rate. The financial intervention mechanisms of the EMS offer some degree of guarantee against such pressures.
3. To the extent that changes in world prices or in the exchange rate affect a large proportion of items in the domestic price index, price movements inside the country are heavily influenced by external disturbances. The percentage of "imported" inflation under flexible exchange rates is higher the smaller the economy.

4. The low degree of diversification of the country's output tends to reduce the price elasticities of exports and imports, so that the changes in domestic activity necessary to correct external imbalances are necessarily large.
5. The small open economy is a price taker in the international market. This implies that expenditure-switching policies (i.e. altering the relative price of traded to non-traded goods) are not an effective means of correcting balance of trade deficits, which require instead changes in domestic absorption. It also implies that any attempt on the part of the monetary authorities to raise the domestic money supply above the amount which individuals and firms demand leads to a balance of payments deficit and a loss of reserves.
6. Joining the EMS, in relation to a stabilisation policy means a stabilisation of the drachma's exchange rate. This would have favourable effects on Greece's terms of trade⁽⁵¹⁾.

Throughout this paper Greece's adhesion to the EMS was seen as an element in a general stabilisation policy and in the fight against inflation. Adhesion to the EMS would not be possible without a reduction of inflation in Greece. An anti-inflationary policy might have some cost in terms of unemployment (although this is not at all certain, since it rests on the assumption of the existence of the Phillips curve) but even so, this cost is only transitory and must be compared to the permanent (and increasing) cost of high inflation.

Greece's adhesion to the EMS also raises some specific questions:

- 1) The problem of a depletion of reserves of foreign exchange. One cause of reluctance to join the EMS could be that Greece's reserves of foreign exchange would be depleted rapidly in interventions of the Bank of Greece in an endeavour to keep the exchange rate of the drachma within the margins of the EMS. This is certainly reasonable in the present situation with Greece's inflation lying much above the European average. But this fear is no longer valid in the context of a stabilisation policy, when the inflation rate would be much reduced. In this context the reduction of inflation and stable exchange rates within the EMS would be parallel and mutually supporting aims. Further, the financial support mechanisms of the EMS are sufficient to meet such eventualities. Also, the drachma

could benefit from a larger margin of fluctuation within the EMS, like the Italian lira, which would require less intervention (or less frequently). Lastly, the central parities of the EMS can be realigned if necessary.

- 2) Adhesion to the EMS would require the liberalisation of capital movements to some degree, and the existence of a real foreign exchange market for the drachma, where the daily bilateral exchange rates could be set. This liberalisation of capital movements is foreseen after the transition period of five years, i.e. in 1985. The drachma could join the EMS at about this time, or later, on condition that a stabilisation policy will have succeeded in reducing inflation to an acceptable level. The Greek government could accordingly choose the appropriate time and fluctuation margin for Greece's adhesion to the EMS.

The success of the stabilisation policy depends primarily on wage behaviour. Some form of incomes policy can then be chosen as an accompanying measure⁽⁵²⁾.

The following options are possible:

- (1) The setting of monetary targets. In countries that have introduced such targets like Germany, the targets are thought to have had an important impact on price expectations, because if trade unions, and employers recognize that the growth of nominal demand will be effectively dampened by the target, so that a rate of wage increases in excess of that target will lead to slower growth of output and employment and these consequences are regarded as undesirable. The conditions are met for a direct impact from the monetary target on prices and wages. The announcement of targets then becomes akin to a declaration of a non-mandatory indirect incomes policy. The evaluation of the German experience is positive⁽⁵³⁾.
- (2) Direct incomes policy. Here also there are various possibilities, ranging from: 1. the German 'concerted action' model, where incomes policy serves as a common framework of assumptions and data on the economic situation on which the bargaining process is based; 2. the Norwegian "quid pro quo" model where wage and income moderation is implemented with the state granting tax reductions; 3. the "coersive" model where the government unilaterally prohibits wage and income increases above a limit set by it for certain periods; to 4. combinations of cases 1-3 with price controls⁽⁵⁴⁾.

Although the experience with incomes policy is different from country to country it seems that especially in smaller countries incomes policy has exerted a moderating influence on cost developments and so on inflation. Smaller countries are often better placed to try to reach a consensus on economic policy through discussion and negotiation simply because of their size that implies less diversity, easier communication and fewer decision makers, and sometimes, the traditions of social and political cohesion. Also, under partially rational expectations incomes policy has a potentially powerful role to play in disciplining expectations and wage aspirations. Furthermore, they can be viewed as instruments to reduce uncertainty, because in indeterminate situations, as those which arise out of the oligopolistic character of bilateral bargaining, there always exists the possibility of an irregular, unforeseeable element of decision making. In the absence of incomes policies such disturbances could create inflationary shocks that monetary and fiscal policy could find difficult to cope with. The response to the uncertainty arising out of the indeterminacy is centralisation and a government incomes policy is such a method of centralisation.

One explanation for trade unions accepting incomes policies is that such policies appear to be a less costly way to reach agreements which yield almost identical results as those of more aggressive forms of strategy (like strikes). If the final outcome is likely to be the same as in the absence of a policy, acceptance would increase predictability in collective bargaining, reduce the risk and the loss of open conflict, and thus make the same economic conflict possible at lower cost for the union and its members⁽⁵⁵⁾.

The establishment of an incomes policy as a place for centralisation of the bargaining process on the lines of the German or the Norwegian model seems to offer important advantages also for Greece, in relation to a general stabilisation policy.

A stabilisation policy is necessary in Greece due to the very high inflation still existing. The Greek government has already embarked on such a policy, setting the target of 20% inflation for 1983 (e.g. a reduction of 3-4% compared to 1982). Such a stabilisation policy necessitates the use of all economic instruments available. In the framework of such a policy-mix, the adhesion of the drachma to the EMS at the appropriate moment would be an additional positive element in safeguarding the external side of the economy.

NOTES

- (1) As yet there are no provisions for Greece's adhesion to the EMS and no studies on this subject have been undertaken, either by the Commission or by any Greek public authority, such as the Ministry of National Economy or the Bank of Greece. The drachma will be included in the basket of the EMS by 31.12.85, at the latest, as provided by Greece's accession Treaty. The exact amount to be included in the basket has also not yet been decided. There are no central rates ECU-drachma, but only daily rates.
- (2) See "The European Monetary System", in *European Economy*, No 3, 1979, p. 67.
- (3) See John Williamson "The Failure of Global Fixity" and Alexandre Lamfalussy "The Failure of Global Fixity?", both in R. Triffin "The Emerging EMS" *Bulletin de la Banque Nationale du Belgique*, April 1979, p. 31 and p. 44.
- (4) For the various options for a European Monetary Union, see the articles in M. Fratianni, Th. Peeters "One Money for Europe", McMillan, London 1978, Commission of the EC, *Optica Report 1976*, "Inflation and Exchange Rates - Evidence and Policy Guidelines for the EEC", Brussels, 10 February 1977, R. Vaubel "Plans for a European Parallel Currency and SDR Reform" in *Weltwirtschaftliches Archiv*, No 2 1974, R. Vaubel "Free Currency Competition" *Weltwirtschaftliches Archiv* No 3, 1977, C. C. von Weizsäcker "Ein Vorschlag zur Währungsunion" in "Beiträge und Stellungnahmen zu Problemen der Währungspolitik" *Kieler Diskussionsbeiträge*, 10 June 1971 J. Léonard "Crise des monnaies, stabilisation et contraintes internationales", C.R.E.P.P.R.A., December 1980, N. Kyriazis, Th. Paccoud "European Monetary Union - An alternative Approach", *Research and Documentation papers of the EP*, Economic Series No 3, July 1981, and J. Léonard "L'ECU et l'avenir monétaire de l'Europe", Université d'Amiens, C.R.E.P.P.R.A. January 1983.
- (5) I am following here a scheme developed by Dr. K. Revelas at a conference in the European Parliament, March 18, 1983.

- (6) See Commission of the EC, European Economy No 12, "Documents relating to the EMS", July 1982, p. 23-24.
- (7) Ibid, p. 25.
- (8) See Jacques van Ypersele de Strihou "The Future of the EMS", Brussels 1981, p. 183.
- (9) For the financial mechanisms of the EMS see Commission of the EC, European Economy No 3, "The EMS", 1979, p. 76-78. Among these mechanisms, only the very short-term financing has been used till now. The medium-term financial assistance is conditional, with a borrower country having to agree to certain economic and monetary conditions.
- (10) See Niels Thygessen "The Emerging EMS: Precursors, First Steps and Policy Options" in R. Triffin "The emerging EMS", Bulletin de la Banque Nationale de Belgique, April 1979, p. 112.
- (11) See R. Vaubel, "Logische Implikationen und Auswirkungen des EWS", Zeitschrift für Wirtschafts - und Sozialwissenschaften, 1981.
- (12) Ibid, algebraic proof, p. 21-22.
- (13) See Hans Willgerodt "The EMS, The Position of the Federal Republic of Germany", in Groupe de reflexions économiques et financières, colloque international, "Le Système Monétaire Européen", 14 juin 1979, p. 3-4. See also Wolfgang Cezanne "Währungsintegration in der EG: Entwicklung und Stand der Diskussion", in Integration 4/80, Beilage zur Europäischen Zeitung 10/80.
- (14) See M. Sumner, G. Zis "Whither European Monetary Union?", 1980, p. 56-57.
- (15) See R. Vaubel, p. 15, H. Willgerodt, p. 5.
- (16) See N. Thygessen, p. 115.

- (17) *ibid*, p. 120.
- (18) See Karl Otto Pöhl "Die Rolle des EWS in der internationalen Währungsordnung", speech to the European Management Forum, Davos, 3 February 1981.
- (19) See J. van Ypersele, p. 188.
- (20) For a detailed study of the Greek economy see N. Kyriazis "Griechenlands Beitritt zur EG: Auswirkungen auf die Industrialisierung" Bonn 1979, N. Kyriazis "Greece'S Accession to the EC", Research and Documentation Papers of the European Parliament, Economic Series No 4, August 1982. See also Commission of the EC, European Economy No 14, "Annual Economic Report 1982-83", November 1982.
- (21) See table No 7.
- (22) See European Economy No 14, p. 25.
- (23) For a summary of the Commission's answer see Annex 1.
- (24) For a detailed analysis of the institutional framework of the Greek Banking System, Greek monetary policy and its implications, see George D. Demopoulos "Monetary Policy in the Open Economy of Greece" Centre of Planning and Economic Research, Athens, 1981.
- (25) This can be seen by a comparison of tables 3 and 4 (interest rates) with tables 1 and 2 (GDP and private consumption) deflators. For 1981, taking the GDP deflator and nominal long term interest rate the real long term interest rate would be -3.4%. For 1981, taking the private consumption deflator and nominal short term interest rates, the real short term interest rate would be -7.6%.
- (26) This is the conclusion of G. Bitros "The Fungibility Factor in Credit and the Efficacy Question of Selective Controls" Bank of Greece, November 1976.

- (27) Demopoulos, *op. cit.* p. 104-105.
- (28) See Niels Thygesen, "Monetary Policy" in A. Boltho "The European Economy, Growth and Crisis", Oxford UP, 1982.
- (29) See interview of Minister of National Economy, Mr. G. Arsenis, (at the time Governor of the Bank of Greece) to the newspaper "ETHNOS", 12 January 1982.
- (30) See declaration of Mr. Arsenis on 22 March 1983 (e.g. newspaper "ETHNOS") and Ach. Mitsos "The accession to the EC", Athens January 1981, p. 380-382. (in Greek).
- (31) The "structural" element in the explanation of inflation has been stressed among others by the two Ministers for National Economy, Prof. A. Lazaris, in interview to newspaper "ETHNOS", 1 February 1982 and G. Arsenis' interview to the same newspaper, 12 January 1982.
- (32) Some of the arguments presented here were presented in a previous paper. See N. Kyriazis "The Drachma and the EMS", in Review of European Communities, No. 2, 1981 (in Greek).
- (33) See H. Christie, M. Fratianni "European Monetary Union; Rehabilitation of a Case and Some Thoughts for Strategy" in M. Fratianni, Th. Peeters "One Money for Europe", and P. Minford "The Exchange Rate and Monetary Policy", W. Buiter, M. Miller "Monetary Policy and International Competitiveness: The Problem of Adjustment" and M. FG. Scott "How best to deflate the economy", all in W. A. Eltis and P. J. N. Sinclair "The Money Supply and the Exchange Rate", Clarendon Press, Oxford 1981.
- (34) See also P. Korteweg "Exchange Rate Policy, Monetary Policy and Real Exchange Rate Variability", in Essays in International Finance, Princeton University, No. 140, December 1980, K. O. Faxén "Incomes Policy and Centralised Wage Formation" in A. Boltho "The European Economy, Growth and Crisis", Ch. Allsopp "Inflation" in A. Boltho.

- (35) See M. Albert "Le Pari Français", Seuil, Paris 1982 and D. Laidler "Some Policy Implications of the Monetary Approach to Balance of Payments and Exchange Rate Analysis" in Eltis and Sinclair.
- (36) For a model of the determination of the nominal and real exchange rate see W. Beenstock, A. Budd and P. Warburton "Monetary Policy, Expectations and Real Exchange Rate Dynamics" in Eltis and Sinclair. This long-run portfolio balance theory of the exchange rate incorporates the relative money supply theory as a special case. See also Cortweg op. cit.
- (37) Monetarists argue of course that monetary measures and even fiscal measures would not have any effects on real variables. "The scope for the real economy to expand through fiscal measures does not exist in any case; a fiscal expansion, accompanying the 'devaluation' would simply raise inflation permanently". See P. Minford, op. cit., p. 141. See also W. Thygesen "Monetary Policy".
- (38) See Chr. Allsopp "Inflation", in A. Boltho.
- (39) If S is $\frac{\$}{\text{DR}}$ ($\$$ = Dollar, DR = Drachma), P the domestic price level and P_F the foreign (here the US), then we have for the real exchange rate
$$e = S \cdot \frac{P}{P_F}$$
, S being the nominal exchange rate.
- (40) For the effect of a change in the exchange rate on the balance of payments there are three basic approaches. The elasticities approach with the well known Marshall-Lerner condition, the absorption approach and the monetary approach. See S. S. Alexander "Effects of a Devaluation on a Trade Balance", International Monetary Fund Staff Papers, 2 April 1952, S. S. Alexander "Effects of a Devaluation; A Simplified Synthesis of Elasticities and Absorption Approaches", American Economic Review, XLIX, March 1959, D. Laidler "Some Policy Implications of the Monetary Approach to Balance of Payments and Exchange Rate Analysis" in Eltis and Sinclair, P. Minford, op. cit. and A. Budd, G. Dicks "Inflation - A Monetarist Interpretation" in A. Boltho. For a generalised mathematical presentation of the three approaches and their criticism see A. Takayama "International Trade" Holt, Rinehart and Winston, 1972.

- (41) See the conclusions by P. J. N. Sinclair in Eltis and Sinclair. The monetarists of course deny the real effects of exchange rate change: "...spot exchange rates cannot be used to devalue a currency in real terms in order to improve a country's competitive position. With money illusion absent, higher prices will be passed promptly to higher nominal wages, leaving the real wage rate unchanged. Likewise, discretionary increases in a currency's spot exchange rate, away from its equilibrium value, will increase import prices and the cost of production, which will be passed on promptly to higher domestic wages and prices, leaving the real exchange rate unchanged". P. Korteweg, *op. cit.* p. 22, and "Monetary growth, provided it contains no "surprises", will not show up in the real exchange rate at all. The determinants of the real exchange rate are real things, notably the social security taxation regime". P. Minford, *op. cit.* p. 122.
- (42) See J. Llewellyn and S. Potter "Competitiveness and the Current Account" in A. Boltho and M. Albert, *op. cit.*
- (43) See Demopoulos, *op. cit.*
- (44) See P. Korteweg, *op. cit.*, N. Thygessen *op. cit.* M. Beenstock et. al., *op. cit.* and A. Lamfalussy, "The Failure of Global Fixity?" in R. Triffin, *op. cit.*
- (45) I am of course not arguing that the adhesion to the EMS without the necessary accompanying measures would be sufficient in itself to reduce inflation. The EMS and relative exchange rate stability is only one element in a stabilisation, although an important one.
- (46) See O.J. No L 200 of 8.8.1979.
- (47) See D. Laidler "Difficulties with European Monetary Union" in M. Fratianni and Th. Peeters.
- (48) See P. Kohnert, N. Kyriazis "Inflation and the State's Expenditure" in "OIKONOMIKOS", 31 August 1978. where the results of an empirical study for Germany are presented (in Greek).

- (49) Even countries which had already implemented some form of indexation of tax brackets and allowances (as Greece did also recently), did not escape this effect because adjustments for the effect of inflation were made with a time lag of about fifteen to twelve months.
- (50) The level of direct taxes figured prominently in the political discussions in the Netherlands and Denmark. See M. J. Artis "Incomes Policies: Some Rationales", J. T. Addison "Incomes Policy: The Recent European Experience" and R. F. Elliott and J. L. Fallick "Incomes Policies, Inflation and Relative Pay: An Overview", all in J. L. Fallick and R. F. Elliott "Incomes Policies, Inflation and Relative Pay", George Allen and Unwin, London 1981.
- (51) See H. Christie and M. Fratianni "EMU: Rehabilitation of a Case and Some Thoughts for Strategy" in M. Fratianni and Th. Peeters and G. Vangrevelinghe "Le Système Monétaire Européen", Groupe de réflexions économiques et financières, Colloque 14 juin 1979.
- (52) The Greek government has recently introduced a form of incomes policy. See the second part of the present study.
- (53) It must be remarked that the formulation and announcement of the monetary target by the Bundesbank was part of an integrated and comprehensive "concerted action" that involved the Bundesbank, the federal government and employers and trade unions representatives. There was no question of surprising the public with next year's monetary target. The investigation of the German success must therefore focus attention on the factors which made this approach to stabilisation policy feasible and not alone in the monetary component. See N. Thygesen "Monetary Policy", op. cit.
- (54) For the implementation and the experience with various forms of incomes policy in Europe see J. T. Addison "Incomes Policy: The Recent European Experience" in Fallick and Elliott.
- (55) See Karl-Olof Faxén "Incomes Policy and Centralised Wage Formation" in A. Boltho.

Table 1

Price deflator of GDP at market prices

	<i>(national currency, annual percentage change)</i>										
	B	DK	D	GR	F	IRL	I	L	NL	UK	EC
1958	1.5	1.8	3.4	1.6	11.8	5.8	2.5	:	1.8	4.0	4.8
1959	0.8	3.6	0.8	0.2	5.7	2.7	-0.7	-1.8	1.2	1.1	1.7
1960	0.7	1.8	3.4	3.5	3.5	0.3	0.0	4.1	3.4	1.5	2.7
1961	1.3	4.3	4.2	1.5	3.4	2.5	2.8	0.4	2.6	3.4	3.3
1962	1.7	6.6	3.9	4.6	4.7	4.9	5.8	-1.0	3.2	3.7	4.4
1963	3.0	5.8	2.7	1.4	6.4	2.7	8.5	5.0	5.0	2.3	4.5
1964	4.7	4.6	3.2	3.7	4.1	9.7	6.5	5.4	8.4	3.6	4.6
1965	5.1	7.4	3.4	4.0	2.7	4.4	4.2	3.4	6.1	5.0	4.4
1966	4.2	3.6	3.7	4.8	2.9	4.4	2.2	3.0	6.0	4.5	3.6
1967	3.1	6.0	1.3	2.5	3.2	3.3	2.8	1.0	4.2	2.9	2.6
1968	2.7	7.2	1.9	1.7	4.2	4.2	1.7	5.1	4.2	4.0	3.2
1969	4.8	6.8	3.6	3.4	6.6	9.1	4.1	5.5	6.4	5.5	5.3
1970	4.8	8.1	7.3	3.9	5.6	9.7	6.9	11.2	5.6	7.3	6.8
1961-70	3.5	6.0	3.5	3.1	4.4	5.5	4.5	3.9	5.2	4.2	4.3
1971	5.4	7.9	7.6	3.8	5.8	10.5	7.2	-0.8	8.5	9.3	7.5
1972	6.2	9.0	5.5	4.5	6.2	13.4	6.3	4.9	9.4	8.3	6.8
1973	7.0	10.5	6.0	19.4	7.8	15.3	11.6	10.6	8.4	7.1	8.2
1974	12.2	12.8	6.7	21.0	11.1	6.1	18.5	17.7	9.3	15.0	12.5
1975	12.6	12.8	6.4	12.3	13.4	22.3	17.5	-1.0	11.2	26.9	15.0
1976	7.5	8.7	3.4	15.4	10.1	20.2	18.0	-12.9	8.9	14.7	10.5
1977	7.1	8.8	3.8	13.0	8.9	12.3	19.1	0.9	6.3	14.0	9.8
1978	4.1	10.3	3.7	12.9	9.8	10.6	13.9	5.8	5.2	10.9	8.3
1979	4.2	7.7	3.8	18.7	10.6	12.4	15.7	6.9	4.2	15.1	9.3
1980	4.3	8.4	4.7	18.4	11.5	14.1	20.4	6.8	5.3	18.9	10.8
1971-80	7.0	9.7	5.2	13.8	9.5	13.6	14.7	6.3	7.6	13.9	9.8
1981	5.4	9.5	4.2	19.7	11.7	17.8	17.6	5.0	5.5	12.1	10.6
(1982)	7.3	10.6	4.8	21.7	12.4	19.2	17.5	8.7	6.2	8.4	10.6

Table 2

Price deflator of private consumption

	<i>(national currency, annual percentage change)</i>										
	B	DK	D	GR	F	IRL	I	L	NL	UK	EC
1958	0.1	0.5	2.5	0.0	12.1	3.8	2.3	:	1.6	2.7	4.3
1959	-0.3	2.5	1.0	-0.5	5.8	0.4	-0.7	:	1.2	1.0	1.8
1960	2.4	2.9	1.0	3.1	3.6	0.9	1.4	:	2.5	1.1	1.7
1961	2.7	3.6	3.6	1.1	3.4	2.4	1.8	0.5	2.1	3.0	2.9
1962	1.0	6.2	3.0	-1.2	4.4	3.6	5.3	0.9	2.7	3.9	4.0
1963	3.7	5.7	2.8	5.8	5.8	2.2	7.1	2.9	3.9	1.9	4.1
1964	4.1	4.0	2.6	2.2	3.4	7.3	5.0	3.1	6.9	3.6	3.9
1965	4.6	6.1	3.3	4.6	2.6	5.0	3.6	3.2	4.1	4.9	4.1
1966	4.1	0.2	3.7	3.5	3.2	2.8	2.9	3.5	5.5	4.0	3.5
1967	2.5	6.7	1.7	1.9	3.1	3.1	3.1	2.3	3.1	2.6	2.5
1968	2.9	7.7	1.8	0.8	5.1	4.4	1.4	2.5	2.7	4.5	3.3
1969	2.9	4.7	2.3	3.0	7.1	7.2	2.9	1.8	6.2	5.6	4.7
1970	3.6	7.1	4.1	3.2	5.0	8.2	5.0	4.0	4.3	6.0	5.1
1961-70	3.2	5.2	2.9	2.5	4.3	4.6	3.8	2.5	4.1	4.0	3.8
1971	5.2	7.8	6.0	2.9	3.5	9.4	5.5	4.7	8.5	8.6	6.6
1972	5.5	8.2	5.6	3.5	5.9	9.6	6.4	5.2	8.9	6.6	6.3
1973	6.0	11.6	7.7	15.0	6.8	11.6	12.4	5.0	9.1	8.6	8.8
1974	12.4	14.8	6.9	23.6	13.2	15.7	20.8	9.9	10.0	17.4	14.1
1975	12.5	9.9	5.9	13.0	11.4	22.3	17.6	10.2	10.7	23.5	13.7
1976	7.9	9.4	4.4	14.0	9.9	18.8	18.1	9.5	8.8	15.5	10.8
1977	6.8	9.9	3.9	11.6	9.2	12.5	18.2	5.8	5.9	15.1	9.9
1978	3.9	9.8	2.4	12.6	8.8	7.5	12.9	3.5	4.3	8.9	7.1
1979	3.9	9.6	4.0	17.7	10.9	13.4	15.0	5.8	4.3	14.3	9.1
1980	6.5	11.5	5.3	23.7	13.2	18.3	20.4	7.7	6.6	15.5	11.1
1971-80	7.0	10.2	5.2	13.6	9.5	13.8	14.6	6.7	7.7	13.3	9.7
1981	9.1	10.7	6.0	24.4	12.5	19.6	19.0	8.1	6.5	10.9	11.8
(1982)	9.0	9.9	5.0	23.0	11.0	18.5	16.6	11.0	6.3	8.8	10.5

Table 3
Short-term interest rates

	BLEU	DK	D	GR	F	IRL	I	NL	UK	EC (%)
1958	:	:	3,6	10,0	6,5	:	3,9	3,0	:	:
1959	:	:	3,2	8,8	4,1	:	3,6	1,9	:	:
1960	:	:	5,1	8,0	4,1	:	3,6	2,1	:	:
1961	4,6	6,3	3,6	8,0	3,7	6,2	3,6	1,1	6,2	4,2
1962	3,4	6,5	3,4	8,0	3,6	5,0	3,6	1,9	5,0	3,9
1963	3,6	6,1	4,0	7,9	4,0	4,3	3,6	2,0	4,3	4,0
1964	4,9	6,2	4,1	7,8	4,7	5,5	3,6	3,5	5,5	4,6
1965	5,0	6,5	5,1	7,8	4,2	6,8	3,6	4,0	6,8	5,0
1966	5,6	6,5	6,6	8,0	4,8	7,0	3,6	4,9	7,0	5,7
1967	5,5	6,6	4,3	8,5	4,8	6,3	3,6	4,7	6,3	4,9
1968	4,5	6,6	3,8	8,3	6,2	7,9	3,6	4,6	7,9	5,3
1969	7,3	8,2	5,8	8,0	9,3	9,2	3,8	5,7	9,2	7,1
1970	8,1	9,0	9,4	8,0	8,6	7,0	5,3	6,2	8,1	8,0
1961-70	5,2	6,8	5,0	8,0	5,3	6,5	3,8	3,8	6,6	5,3
1971	5,4	7,6	7,2	8,0	6,0	6,6	5,7	4,5	6,2	6,3
1972	4,2	7,3	5,6	8,0	5,3	7,0	5,2	2,7	6,8	5,6
1973	6,6	7,6	12,1	9,0	9,3	12,2	7,0	7,5	11,8	9,9
1974	10,6	10,0	9,9	11,8	13,0	14,5	14,9	10,4	13,4	12,2
1975	7,0	8,0	5,0	11,9	7,6	10,9	10,4	5,3	10,6	7,9
1976	10,1	8,9	4,3	11,5	8,7	11,6	16,0	7,4	11,6	9,4
1977	7,3	14,5	4,4	12,0	9,1	8,4	14,0	4,8	8,0	8,3
1978	7,3	15,4	3,7	13,5	7,8	9,8	11,5	7,0	9,4	7,8
1979	10,9	12,5	6,7	16,7	9,7	16,0	12,0	9,6	13,9	10,4
1980	14,2	16,9	9,5	21,0	12,0	16,3	16,9	10,6	16,8	13,4
1970-80	8,3	10,8	6,8	12,3	8,8	11,3	11,3	6,9	10,8	9,1
1981	15,6	14,9	12,4	16,8	15,3	16,7	19,0	11,8	14,1	14,7

Table 4
Long-term interest rates

	BLEU	DK	D	GR	F	IRL	I	NL	UK	EC (%)
1958	:	:	6,5	:	7,6	5,0	6,7	4,3	5,0	:
1959	:	:	5,8	:	6,3	4,8	5,7	4,1	4,8	:
1960	:	:	6,3	:	5,7	5,4	5,3	4,2	5,4	:
1961	5,9	6,6	5,9	:	5,5	6,2	5,2	3,9	6,3	5,5
1962	5,2	6,6	5,9	:	5,4	6,0	5,8	4,2	5,9	5,5
1963	5,0	6,5	6,1	:	5,3	5,6	6,1	4,2	5,4	5,5
1964	5,6	7,1	6,2	:	5,5	6,0	7,4	4,9	6,0	6,0
1965	6,4	8,6	7,1	6,2	6,2	6,4	6,9	5,2	6,6	6,5
1966	6,7	8,7	8,1	7,4	6,6	6,8	6,5	6,2	6,9	6,9
1967	6,7	9,1	7,0	7,4	6,7	6,7	6,5	6,0	6,8	6,6
1968	6,6	8,7	6,5	7,3	7,0	6,5	6,6	6,2	7,6	6,7
1969	7,3	9,7	6,8	7,1	7,9	7,3	6,7	7,0	9,1	7,5
1970	7,8	11,1	8,3	7,4	8,6	7,8	9,0	7,8	9,3	8,5
1961-70	6,3	8,3	6,8	7,1	6,5	6,5	6,7	5,6	7,0	6,5
1971	7,3	11,0	8,0	7,5	8,4	9,2	8,3	7,0	8,9	8,2
1972	7,0	11,0	7,9	7,8	8,0	9,1	7,5	6,7	9,0	7,9
1973	7,5	12,6	9,3	10,4	9,0	10,7	7,4	7,3	10,8	9,1
1974	8,8	15,9	10,4	9,6	11,0	14,6	9,9	10,7	15,0	11,5
1975	8,5	12,7	8,5	9,0	10,3	14,0	11,5	9,1	14,5	10,8
1976	9,1	14,9	7,8	10,0	10,5	14,6	13,1	9,2	14,6	11,0
1977	8,8	16,2	6,2	9,2	11,0	12,9	14,6	8,5	12,5	10,4
1978	8,5	16,8	5,7	9,3	10,6	12,8	13,7	8,1	12,6	10,1
1979	9,7	16,7	7,4	13,3	10,9	15,1	14,1	9,2	13,0	10,9
1980	12,2	18,7	8,5	18,8	13,7	15,4	16,1	10,7	13,9	12,6
1971-80	8,7	14,6	8,0	10,4	10,3	12,8	11,6	8,6	12,5	10,2
1981	13,8	19,3	10,4	16,3	16,3	17,3	20,6	12,2	14,8	14,8

Table 5

Changes in exchange rates within the EMS

(a) Realignments in central rates, percentage change against the group of currencies whose bilateral parities were not changed							
Dates of realignments							
	24 September 1979	30 November 1979	22 March 1981	5 October 1981	22 February 1982	14 June 1982	21 March 1983
BFR/LFR	-	-	-	-	-8,5	-	+1,5
DKR	-2,9	-4,8	-	-	-3	-	+2,5
DM	+2	-	-	+5,5	-	+4,25	+5,5
FF	-	-	-	-3	-	-5,75	-2,5
IRL	-	-	-	-	-	-	-3,5
LIT	-	-	-6	-3	-	-2,75	-2,5
HFL	-	-	-	+5,5	-	+4,25	+3,5

(b) Variations in effective exchange rates ⁽¹⁾ relative to EMS partners, annual percentages					
	<u>1979</u> 1973	<u>1982</u> (2) 1979	<u>1980</u> 1979	<u>1981</u> 1980	<u>1982</u> (2) 1981
B	+1,3	-3,1	-0,1	-0,4	- 9,1
DK	-1,1	-3,9	-6,8	+0,1	- 4,7
D	+4,6	+4,7	+1,2	+3,0	+10,0
F	-3,0	-2,2	+1,0	-1,1	- 6,4
IRL	-6,1	+0,2	+0,1	-0,5	+ 0,9
I	-9,4	-4,8	-3,5	-5,0	- 5,9
NL	+1,7	+2,6	+0,7	+0,7	+ 6,5
UK ⁽³⁾	-4,9	+6,5	+9,9	+9,9	- 0,0

(1) Export weighting, variable from year to year until 1977.

(2) Forecasts: economic budgets, May 1982. The realignment of central rates on 14 June 1982 is taken into account.

(3) In relation to Community countries.

Source: Eurostat and Commission departments, European Economy No 12, July 1982, (revised)

Table 6

Adjustment of relative changes¹ in costs and prices in relation to EMS partners

Country	(a) Relative change in unit labour costs ² -- whole economy; indices in common currency						(b) Relative change in GDP price: indices in common currency					
	Relative level in 1978 (= available margins relative to different base periods = 100)			Relative level in 1982 ³ (= margins still available relative to different base periods = 100)			Relative level in 1978 (= available margins relative to different base periods = 100)			Relative level in 1982 ³ (= margins still available relative to different base periods = 100)		
	1978	1978	1978	1982	1982	1982	1978	1978	1978	1982	1982	1982
	1970	Ø 61-70	Ø 68-72	1970	Ø 61-70	Ø 68-72	1970	Ø 61-70	Ø 68-72	1970	Ø 61-70	Ø 68-72
B	117,8	111,4	115,1	99,0	93,9	96,9	105,6	102,5	105,7	87,8	85,2	87,9
DK	102,7	104,8	102,7	90,3	92,1	90,3	110,2	112,5	110,3	100,7	102,9	100,8
D	99,1	106,4	103,0	94,6	102,0	98,8	104,0	111,2	107,2	101,9	109,0	105,0
F	92,6	81,1	89,3	103,0	90,2	99,3	92,9	83,3	89,9	98,6	88,4	95,4
IRL	77,9	74,8	82,2	103,0	99,0	106,2	82,6	80,1	83,4	110,4	107,0	111,5
I	82,7	81,4	82,7	95,7	94,2	95,8	77,6	76,5	78,0	90,9	89,6	91,4
NL	112,9	121,7	111,5	112,6	121,3	111,2	119,1	123,2	116,3	121,2	125,2	118,3
UK ⁴	76,3	69,8	77,7	112,2	102,6	114,2	80,1	73,4	80,6	117,8	107,9	118,5

¹ Export weighting, variable from year to year until 1977.

² Index of compensation of employees per employee divided by the index of productivity per person employed.

³ Forecasts: economic budgets, May 1982. The realignments of 14 June 1982 are taken into account.

⁴ Change relative to Community countries.

Sources: Eurostat and Commission departments.

Table 7

Greece: main economic aggregates, 1961-83

	GDP value growth	GDP volume growth	GDP price deflator	Rise in consumer prices	Compensation per employee	Current account of balance of payments	General government balance	Money supply growth M2 ¹	Unemployed labour force
	"	"	"	" ²	" ²	" GDP	% GDP	"	"
1961-70	11,0	7,6	3,1	2,5	9,8	-3,1	:	17,6	:
1971-80	19,1	4,7	13,8	13,6	18,3	-2,7	:	23,8	:
1980	20,3	1,7	18,4	23,7	16,2	-0,9	:	24,7	2,8
1981	18,9	-0,7	19,7	24,4	27,1	-2,2	-10,1	34,3	3,1
1982 ¹	22,5	0,7	21,7	23,0	27,4	-2,4	-9,2	29,1	3,8
1983 ¹	23,0	1,9	20,7	21,0	21,0	-2,3	-8,6	23,0	4,0

¹ Preliminary estimate of the Commission services on the basis of present or anticipated policies.

² % change over previous period, annual rate.

³ End of year.

Table 8

Current account of balance of payments

(as % of GDP)

	BLEU	DK	D	GR	F	IRL	I	NL	UK	EC
1958	3.9	2.9	2.5	:	-0.4	-1.6	2.0	4.5	1.7	1.7
1959	0.7	0.4	1.6	:	1.5	-6.4	2.5	4.8	0.7	1.5
1960	0.7	-1.6	1.6	-2.9	1.5	-0.1	0.8	3.0	-1.0	0.7
1961	0.3	-2.0	1.0	-2.2	1.1	0.2	1.2	1.4	0.0	0.7
1962	0.7	-3.4	-0.1	-1.6	1.0	-1.8	0.6	1.1	0.4	0.4
1963	-0.4	0.1	0.2	-2.2	0.3	-2.8	-1.4	0.7	0.3	-0.0
1964	0.2	-2.4	0.2	-4.3	-0.3	-3.5	1.1	-1.1	-1.3	-0.3
1965	0.6	-1.8	-1.3	-5.8	0.8	-4.4	3.6	0.1	-0.2	0.2
1966	-0.1	-1.9	0.3	-2.0	0.1	-1.6	3.2	-1.0	0.1	0.4
1967	1.2	-2.4	2.2	-2.2	0.0	1.4	2.2	-0.3	-0.9	0.7
1968	1.4	-1.7	2.3	-3.6	-0.5	-1.3	3.3	0.3	-0.8	0.8
1969	1.8	-2.8	1.4	-4.0	-1.1	-4.8	2.7	0.3	0.7	0.6
1970	3.2	-3.9	0.6	-3.1	0.1	-4.0	1.2	-1.5	1.3	0.5
1961-70	0.9	-2.2	0.7	-3.1	0.2	-2.3	1.8	0.0	-0.0	0.4
1971	2.3	-2.4	0.4	-1.5	0.6	-3.8	1.8	-0.3	1.8	0.8
1972	3.9	-0.4	0.4	-1.3	0.5	-2.2	1.6	3.0	0.2	0.8
1973	2.8	-1.7	1.3	-3.8	-0.2	-3.1	-1.8	4.0	-2.0	0.0
1974	1.7	-3.1	2.6	-3.3	-2.3	-9.4	-4.7	3.2	-4.6	-1.0
1975	0.7	-1.5	0.9	-4.2	-0.0	-0.2	-0.2	2.5	-2.0	-0.0
1976	0.4	-4.9	0.8	-2.6	-1.5	-3.4	-1.5	3.2	-1.7	-0.5
1977	-0.5	-4.0	0.9	-2.7	-0.7	-2.8	1.2	0.8	-0.1	0.1
1978	-0.7	-2.7	1.5	-2.3	0.6	-3.1	2.4	-0.8	0.4	0.8
1979	-1.8	-4.5	-0.6	-2.9	0.1	-9.8	1.7	-1.3	-0.0	-0.4
1980	-4.2	-3.8	-1.8	-0.9	-1.4	-8.4	-2.5	-1.4	1.2	-1.4
1971-80	0.5	-2.9	0.6	-2.7	-0.4	-4.6	-0.2	1.3	-0.7	-0.1
1981	-4.4	-3.2	-1.1	-2.2	-2.0	-13.2	-2.3	2.3	2.4	-0.8
(1982)	-3.2	-4.1	0.0	-2.4	-2.6	-9.0	-1.3	4.0	0.8	-0.7

Table 9

ECU exchange rates

(national currency per ECU, annual average)

	BLEU	DK	D	GR	F	IRL	I	NL	UK	USA
1958	54.8350	7.57507	4.60614	32.9010	4.61264	0.391678	685.438	4.16745	0.391678	1.09670
1959	52.8101	7.29535	4.43605	31.6863	5.21454	0.377215	660.126	4.01357	0.377215	1.05621
1960	52.8101	7.29535	4.43605	31.6863	5.21454	0.377215	660.126	4.01357	0.377215	1.05621
1961	53.3667	7.37224	4.30742	32.0202	5.26950	0.381191	667.084	3.89854	0.381191	1.06734
1962	53.4901	7.38928	4.27921	32.0943	5.28168	0.382073	668.626	3.87268	0.382073	1.06981
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1964	53.4901	7.38928	4.27921	32.0943	5.28168	0.382073	668.626	3.87268	0.382073	1.06981
1965	53.4901	7.38928	4.27921	32.0943	5.28168	0.382073	668.626	3.87268	0.382073	1.06981
1966	53.4901	7.38928	4.27921	32.0943	5.28168	0.382073	668.626	3.87268	0.382073	1.06981
1967	53.2404	7.42293	4.25924	31.9446	5.25703	0.387652	665.506	3.85461	0.387652	1.06482
1968	51.4442	7.71663	4.11554	30.8667	5.07967	0.428702	643.052	3.72456	0.428702	1.02889
1969	51.1093	7.66640	4.02622	30.6657	5.29027	0.425912	638.866	3.70032	0.425912	1.02219
1970	51.1116	7.66675	3.74138	30.6668	5.67767	0.425931	638.895	3.70049	0.425931	1.02223
1971	50.8663	7.75264	3.64566	31.4328	5.77214	0.428583	647.414	3.65750	0.428583	1.04776
1972	49.3611	7.78909	3.57681	33.6533	5.65717	0.448941	654.264	3.59991	0.448941	1.12178
1973	47.8009	7.41598	3.27644	36.9519	5.46775	0.502321	716.460	3.42853	0.502321	1.23173
1974	46.3994	7.25927	3.08352	35.7810	5.73386	0.509803	775.743	3.20224	0.509803	1.19270
1975	45.5690	7.12266	3.04939	39.9941	5.31923	0.560026	809.545	3.13490	0.560026	1.24077
1976	43.1654	6.76176	2.81545	40.8842	5.34486	0.621578	930.150	2.95515	0.621578	1.11805
1977	40.8826	6.85567	2.64831	42.0353	5.60607	0.653701	1 006.785	2,80010	0.653701	1,14112
1978	40.0611	7.01946	2.55608	46.7829	5.73984	0.663898	1 080.216	2,75410	0.663920	1,27410
1979	40.1651	7.20912	2.51088	50.7738	5.82946	0.669492	1 138.498	2,74865	0.664402	1,37065
1980	40.5979	7.82737	2.52422	59.3228	5.86896	0.676007	1 189.205	2,76028	0.598498	1,39233
1981	41.2946	7.92256	2.51391	61.6241	6.03993	0.691031	1 263.180	2,77511	0.553120	1,11645
(1982)	44.4227	8.13665	2.39150	64.7323	6.36781	0.689203	1 318.499	2,63548	0.558673	0,99710

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The European Commission has replied to the Greek memorandum of March 1982 by a series of proposals to the Council, the aim of which is :
- to help the Greek government and people to achieve a thoroughgoing transformation of the country's economic structures,
- to speed up Greece's integration in the Community.

The proposed measures come under Community regulations, with certain provisional derogations where appropriate. The only really significant derogation is that concerning taxation arrangements. In practice the Commission has abandoned the idea of acting against the Greek infringements under Article 95 of the EEC Treaty (which states that taxes on imported products cannot be higher than those on similar national products), provided that a gradual timetable is drawn up for removal of these infringements and for the introduction of VAT. EUROPE would point out that in this field the "discriminations" applied by Greece are quite considerable ; in point of fact, the taxes imposed on imported products amount to customs duties. The Commission views this problem in the context of the overall reform of the tax system in Greece, which requires a certain amount of time. In practice, the Commission is introducing a sort of special transitional period for application of Article 95. The timetable to be laid down has not yet been established ; it is possible that in the end it will be negotiated (at least where the new date for introducing VAT, instead of 1 January 1984 - now abandoned - is concerned) in the Council, in the context of the examination of the Commission's proposals. Introduction of VAT should serve to settle the taxation problem at the root, since VAT is designed to replace all the other import taxes.

The Commission's reply contains two major sections :

A. "Integrated Mediterranean programmes" and other measures already arranged. In recent months various measures have been taken for Greece's benefit, particularly in the agricultural sector (FEOGA intervention rate, special fundings, etc.) and Greece should benefit in special fashion from certain programmes that are already a matter of general acceptance, such as the first programme of structural aids for fisheries. In addition and above all, the Commission considers that its proposal concerning "integrated Mediterranean programmes" constitutes a direct and satisfactory response to a large number of the structural questions which arise in the memorandum. Pending further detailed discussion of the contents of these "programmes" (which will affect Italy, France and Greece), EUROPE would point out that the funding earmarked for Greece under this heading amounts to 2,542 ECUs for the period 1985/1991, of which 1,233 million for agriculture, 120 million for forestry, 139 million for fisheries, 1,048 million for actions other than the above.

B. New proposals. There are a large number of these. The principal ones relate to the following points :

1) Five-Year Plan - Major Projects. In June 1982, the Commission welcomed the fact that the Greek Government had in preparation a five-year plan for economic development and the restructuring of the Greek economy. In the course of the mission exercise, the Greek Authorities informed the Commission about the major projects envisaged in this plan. The Commission has now decided that when certain of those projects have been presented and examined, it will be prepared if necessary to propose to the Council that special measures should be added to the intervention of existing Community instruments.

2) Agriculture. The Commission proposes the extension to the entire rural area of Greece of a series of measures concerning irrigation, forestry and infrastructure.

Both the Commission and the Greek Authorities are seriously concerned about the insufficiencies of the Greek system of quality control: the Commission now proposes exceptionally a measure aiming at the development of the means necessary for an increase in the number of rhythm of quality controls. This will involve the hiring and training of quality control personnel.

3) Employment and Social Policy. The Commission wishes to assist the Greek Authorities to modernise the training system in Greece. The Commission proposes financial aid for the construction and equipment of training centres in urban areas (similar action is already envisaged for other areas in the Mediterranean Integrated Programme for Greece).

The Commission also proposes financial assistance towards the improvement of the social and professional rehabilitation system for certain categories of handicapped people. This will involve the building and equipment of hospitals and the introduction of modern techniques.

These actions which will have a duration of 4 years are both intended to put Greece in a position to make greater use of the resources of the Social Fund.

4) Transport

- Infrastructure. The Commission proposes for the years 1984/85 a substantial measure in favour of those transport infrastructure projects which have a Community interest, which is to be added to the experimental programme on transport infrastructure of the Community.

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- Transport Costs. In the course of the missions, the Greek Authorities presented a series of demands arising from the cost of transport in the Greek agricultural sector created by the geographical position and configuration of Greece. The Commission believes that some of these demands require Community action pending the development of transport infrastructure. The Commission undertakes to propose a number of actions for a limited period aimed at reducing the effects on productivity of these specific Greek circumstances.

5) Environment. Given the enormity of the pollution and congestion problem of Athens, a solution will only be found through a long-term action involving a coordinated approach to its many dimensions. The Commission is already helping to develop a basis for such an approach through the financing of feasibility studies and pilot experiments in Athens. The Commission will continue to cooperate with the Greek Authorities in the search for a comprehensive action programme. When this policy has been established, the Commission will furthermore present proposals for appropriate Community participation in its implementation.

6) research and technology. The Commission stresses that a key factor in the Greek strategy, on which the success of the country's policy where science is concerned largely depends, is the need for equipment and facilities. A special effort on the part of Greece will be able to be supported by the existing Community instruments for financing. In addition, the EEC can take part in carrying out specific research contracts, and the Commission states that a "Community support action" could be undertaken on the basis of requests to be made by the Greek authorities.

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Will the measures planned suffice to enable Greece to respect and implement all aspects of Community legislation ?

The European Commission considers that the various actions envisaged to assist Greece should enable it to gradually respect and implement all aspects of Community legislation. It bases this attitude on the assumption that such is the will of the Athens government and that the current infringements are the result of objective difficulties. The Commission says that it is aware that the respect of Community obligations in some cases presents particular difficulties ; but the Greeks have an obligation to solve these difficulties and this is an essential element of the process of Greek integration in the Community. The reply to the memorandum mentions two areas :

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In addition to these two areas (discriminatory taxation, see preceding page ; aids to sectors in difficulties), there are others in which Greece is failing to respect Community standards, and in particular, exchange controls, and public markets.

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