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Economic Policies in Greece during 1990–1993: An Assessment

Theodore Pelagidis

Abstract

An analysis of the conservative economic policy of the period 1990–1993 in Greece shows that its results were negative. In order to end the economic crisis in Greece, a new policy is needed that will emphasize economic growth, pay attention to public investment in the infrastructure in order to generate an increase of productivity in the private sector, raise the level of business activity, and reduce the risks faced by individual firms. For the crucial field of exchange rate policy, what is needed is a "crawling peg" policy according to market signals.

Introduction

It is widely felt in Greece that excess demand, extremely high public debt, and budget deficits constitute the main problems of the economy and are responsible for the poor macroeconomic performance since the 1980s. The conservative party, which assumed power early in the 1990s at a time of intense macroeconomic imbalance, immediately adopted a package of hard austerity measures in order to reduce the budget deficit and restrict domestic demand. The persisting economic crisis and the failure of sustainable growth were considered the result of past policies that had increased wages above inflation and productivity and had promoted state intervention especially through the increase of unproductive public consumption expenditures. In 1993, a political crisis provoked by the unpopular austerity measures brought PASOK, the socialist party, back to power. It was believed that PASOK would put an end to the "extreme monetarism" implemented before. However, despite this clearly declared intention, PASOK's economic policy today runs along the same lines as before. Pro-socialist policy makers advise that general stabilization measures, backed by social consensus, are needed to return the economy to a stable macroeconomic environment. Until now, carefully devised political moves and delicate words seem to have been the way to implement a "mild monetarist policy." It is unfortunate that few of the policy makers who support conservative

ideas—even within the socialist party—present convincing arguments to justify the measures taken. At the same time, this blind, *à la mode* devotion to austerity measures prevents them from evaluating the 1990–1993 period dispassionately. In response to such an attitude, I attempt in this paper to explain the goals and rationale of the measures taken and, more importantly, to analyze the results of the extreme monetary prescription applied.

Poor macroeconomic performance and the prevailing diagnosis

It will not be news to anyone that the Greek economy's macroeconomic performance during the 1980s was hardly impressive. Real GDP grew at an average annual rate of only 1.5%, which is a low percentage both *per se* and compared to the GDP increase of the European Union, which was around 2.4% (European Economy 1995:200). Taking into account that Greece as a full member of the EU has both the obligation and the ambition to approach European standards, the increase in Greek GDP was rather mediocre. Despite intense income restraints in various periods (1983, 1986, 1987, 1990), inflation in the past decade proceeded at an annual average rate of 18.4% (European Economy 1995:217). According to European Economy (1995), the current account deficit averaged 25.2% of GDP in the years 1980–1989, while foreign currency debt increased from 10.6% in 1980 to 31% in 1989. At the same time, unemployment rose from 4% in 1981 to 7% in 1989, an almost double increase although still below the European peak rate of 11%. Industrial production remained almost stagnant (0.8% average change during 1984-1991), while the share of manufacturing production as a percentage of GDP retreated from 17.2% in 1975–1979 to 15.8% in 1985–1989, both of which figures may be attributed to poor industrial productivity performance especially in the first five-year period (21.0% in 1980–1984 and 2.4% in 1985–1989).

The deterioration—or at least the relevant stagnation—of the main macroeconomic indicators is considered to be the result of the huge public sector deficit, which ran at an average rate of 17.7% of GDP during 1984–1991 and reached a record level equivalent to almost 19% in 1990, by far the highest level in the OECD area (Barclays Bank 1993:12).

After 1990, the year in which the conservative party assumed power, tough austerity measures were instituted with the goal of stabilizing the economy and bringing Greece closer to its European partners. Economic policy focused on the (supposed) sources of macroeconomic disequilibrium: the huge budget deficits and the excess demand coming

mainly from increases in wages above productivity during the last decade.

Budget deficit, a concept familiar to economists, consists of the amount by which expenditure exceeds tax revenue. This amount must be borrowed or added to the total debt; hence, debt is the sum of all past net borrowings. In the case of Greece, the applied neoconservative analysis (Alogoskoufis 1990, 1991; Economou 1991; Papademos 1989; Pavlopoulos 1986, 1989; Pavlopoulos and Kouzelis 1990) attributes massive deficits to excess spending expenditure, referring in particular to excess public consumption and the increase in private and public sector wages. Most of this expenditure is considered a waste of resources—a waste that crowds out enterprises in the private sector. As a result, nominal interest rates go up in order that the state may be able to obtain capital resources with which to cover its deficits. One must remember that short-term nominal interest rates during the 1980s averaged 17% (European Economy 1995:244), a fact that diverted resources from private investment. On the other hand, excess domestic demand is considered the primary cause of both high inflation and the significant reduction of profits in the private sector that had a negative side-effect on investment decisions and, as a result, on productivity performance. Authors who support these arguments characteristically mention that public expenditure reached an unprecedented 49% of GDP at the end of 1980s, a fact that, together with excess public consumption rates, had a negative effect on inflation as well.

In the reports of the conservative, influential Ινστιτούτο Οικονομικής και Βιομηχανικής Έρευνας (IOBE), the enormous increase of the wage income share during the 1980s is particularly emphasized. The ex-director of the Institute, Professor Economou, points out that the income share of wages increased from 58.2% in 1981 to 66.8% in 1985, a rise that continued for the remainder of the decade (1986–1989). The real wage in manufacturing increased cumulatively 4.4%, while productivity decreased 22.2%, resulting in a total net increase of 16% in real wages for the entire decade (Economou 1991:58, 72). P. Pavlopoulos (1986, 1989), an advisor to the conservative government, gives a detailed estimate of the negative impact on profits owing to an increase in real wages, a fact that is considered extremely important for private investment decisions and hence for an increase in productivity and competitiveness. Both authors argue that real wage increase had a negative side-effect on the marginal propensity to save—savings decreased from 22% of GDP in the 1970s to 6% in 1987.

The conservative policy prescription

Having adopted the above diagnosis, the conservative government proceeded from 1990 onward to implement tough stabilization measures focused primarily on efforts to reduce the deficit from 19% of GDP (1990) to 3%, and the total debt from 76.3 % (1989), to 60% (Epilogi 1993), in order to meet the two most important convergence criteria of the Maastricht Treaty. Hence the conservative government announced a number of drastic fiscal measures meant to bring the economy closer to European standards and to overcome the economic inertia caused almost exclusively, as was believed, by the extremely high public sector borrowing requirements (PSBR). These measures included a drastic overhaul of social security expenditure, higher indirect taxes and higher public utility prices (in order to compensate for the taxation short-fall especially in the 1992–1993 years), and an urgent plan to denationalize state-owned enterprises such as the cement company AGET-Hercules, the Greek telecommunications corporation OTE, shipyards, public transportation, etc. Rapid privatization was meant to rid the state of the deficits of public corporations and to realize money from their sale so that the primary budget balance could show a surplus of 5% of GDP in 1993, rising to 7.7% by 1997. However, we should emphasize that the corporate tax rate was reduced to 35% and the maximum personal income tax rate to 40% (Barclays Bank 1993:6) in order to increase profits and, as was hoped, investment.

Regarding income policy, tough real wage cuts were adopted to diminish labor costs in order to decrease domestic demand and slow down inflation. These measures were considered preconditions for cutting interest rates and hence the state's back payments and deficits. In fact, with inflation pressures persisting at the high levels of 15.8% and 14.5% in 1992 and 1993, respectively, the public sector pay increases of 5% in 1992 and 4% in 1993 brought down relative wage levels and influenced private sector profits positively. Following tough real wage cuts in the period 1991–1993, payroll cuts were expected to reduce the state wages bill from 12.4% to 11% of GDP by 1996 (Barclays Bank 1993:6).

Regarding exchange rate policy, the goal was to keep the drachma within a very narrow range of fluctuation around the ECU (EURO) parity, with the prospect of entering Greece's currency into the European Exchange Rate Mechanism (ERM) as a first step toward Greece's participation in the process of the European Monetary Union (EMU). Recent estimates put the overvaluation of the drachma at 20%–30%, a fact that has resulted partly from an anti-inflationary "hard currency" policy (Alogoskoufis 1993).

Finally, regarding the liquidity of the economy, interest rates were

supposed to begin a process of gradual decrease by early 1994, along with a decrease of public debt. Money supply and credits to the economy contracted. From its peak rate of 23.6% in 1989, credit expansion slowed down to a 16.9% annual percentage change in 1990 and then to 10.8% and 9.8% in 1991 and 1992, respectively (OECD 1993a:60). Similarly, M3 (money supply), from 24.2% in 1989, grew by 15.3%, 12.3%, and 15% for 1990, 1991 and 1992, respectively (OECD 1993a:62). According to conservative policy makers, this was meant to contribute to a drastic decrease in the liquidity of the economy, a fact that usually contributes to a deceleration of inflation and considerably counterbalances the liquidity issuing from the huge budget deficits and the massive debt.

In sum, during the years 1990–1993 the conservative government adopted a variety of tough austerity measures to slow inflation and reduce the budget deficit. This type of irreconcilable monetarism was considered the only way to succeed in easing the country's economic crisis and in meeting the Maastricht criteria. But although the Maastricht Treaty defines concrete nominal economic targets to be reached and sets deadlines, it does not specify which policy should be used to meet its goals. On the contrary, it is supposed to leave each member-state free to utilize appropriate policies in order to reach the Maastricht objectives, although the latter are not designed according to pure economic logic, and are affected by political factors. In any case, leaving aside the Maastricht Treaty *per se*, I will attempt to assess the policy applied since the early 1990s, beginning with an examination of whether the government reached the objectives set.

Critical assessment

Our first task is to consider the diagnosis for macroeconomic disequilibrium. Is excess demand the heart of the problem? We should remember that excess demand was supposedly created by extraordinary increases in wages and in public consumption expenditure during the 1980s.

Contrary to what is commonly believed, however, from 1980 to 1990 the average annual change in total domestic demand in Greece was 1.3% (OECD 1991a), while the GDP per head grew at an annual rate of 1.5% during the same period (European Economy 1995:200). The cumulative change in private consumption in constant prices grew in Greece at 21% (1979–1989) while in the EU it grew at 24% in the same period (OECD 1991b:56). Private consumption in Greece was 51% of the EU average in 1981 but dropped to 41% in 1991, a fact that should be attributed to the fall of relative wage levels from 55–56% of the OECD and EU averages (in common currency) in 1981 to 42–45% in 1991 (OECD 1993a:29). The above evidence, as Vergopoulos rightly

observes (1991, 1992, 1993), is extremely incompatible with the overconsumption theory and with conservative policy makers' interpretation of the crisis. On the other hand, Greece presents the highest saving propensity of households: around 20% compared to the EU average of 14% (AGI 1992:12–13); consequently, we can certainly argue that there is neither an insufficiency of saving nor a tendency to overconsume to the detriment of savings and investments. As for public consumption, although it is true that consumption grew constantly during the decade 1980–1989, it remained at European levels: around 19% of GDP compared to 18.5% in the EU (OECD 1991b:66). The cumulative growth of real public consumption expenditure during the years 1982–1992 was 19.8% for Greece compared to 21.0% for the EU (OECD 1993b:204). It should also be mentioned that public expenditure as a percent of GDP reached the European level (around 50%) only in the late 1980s, although what the state receives from the economy (around 35% of GDP) is far behind European standards (45%), a fact of crucial importance for today's economic inertia in Greece, according to my interpretation.

The above evidence, which refers primarily to the issue of excess domestic demand, is in accord with the evidence concerning labor wages and costs. The real average wage per head grew in Greece at an average annual rate of 0.9% from 1983 to 1990, while in the EU it exceeded 1.5% (European Community 1989:60). The relative labor cost in common currency per unit of product in 1984 was 83.7% of the European cost, while in 1993 it fell to 65.4% (table 1). Finally, Eurostat statistics show that real wages in Greece have decreased by 1.6% per year since 1985, while in all other EU countries real wages have increased from 0.7% in France, the lowest percentage, to 2.8% in Germany, the highest percentage (Eurostat 1992:1).

The above evidence dealing with various aspects of so-called "domestic demand" definitely shows that macroeconomic disequilibrium cannot be attributed to excess demand, overconsumption, and generally unproductive waste of resources caused by excess public or private consumption. Contrary to what is generally believed, the level of domestic demand remained low, in fact lower than the slight increase of GDP, and public consumption and expenditure showed convergence with the EU rather than divergence. At the same time, state revenues and wages diverged even though a socialist government was in power during the 1980s.

I shall now embark on the more complex issue of public debt and deficit, which, as mentioned above, became the main concern of conservative policy makers during the period 1990–1993. As was noted earlier, conservative authors still consider annual public sector borrow-

Table 1. Relative labor cost in Greece per unit of production in common currency*

1984	1985	1986	1987	1988	1989	1990	1991	1992	1993**
83.7	82.2	67.4	63.7	68.5	71.1	72.6	68.1	65.2	65.4

Source: European Economy 1992:258 (**and 1995:260).
*(1961–1973 = 100) in relation to the EU

Table 2. Greek PSBR and Total Debt as a Percentage of GDP

	1988	1989	1990	1991	1992	1993
PSBR*	13.5	19.6	21.0	15.6	10.9	13.3
PSBR†	—	—	18.6	16.1	13.2	13.3
DEBT‡	71.5	76.3	88.8	95.9	101.4	115.2

Sources: *OECD (1993a:51); † Barclays Bank Economic Department: Greece (1993:12); ‡ Epilogi (1993:24).

ing requirements (PSBR) to be responsible for high inflation rates as well as for keeping interest rates up—conditions that, as is commonly believed, divert resources from the private economy, provoking disinvestment and crowding-out effects. I am not going to discuss theoretical issues relevant to the relationship between interest rates and budget deficits; nevertheless, I must point out that government deficits do not necessarily affect interest rates, investments, or anything else because, as Barro (1988) argues, the increase in private savings exactly offsets the decrease in public savings. My own view is that deficits affect interest rates only when an economy nears its potential level of output; they divert resources from private investment only at the point of full employment. Deficit reduction stimulates investment by freeing up resources only when resources are not available. Otherwise, "excessive" deficit reduction makes problems increase. In Greece, gross household savings as a percentage of disposable income were 20.1% in 1991 while in the EU they were 14% (AGI 1992:12–13). In other words, the economy had idle resources available despite high public borrowing—indeed, had them available to such extent that the view that the private economy suffers from crowding-out effects cannot be maintained.

So, contrary to all the demoralizing accusations regarding the wasteful, unproductive Greek state, public consumption and expenditure remain close to European standards. If this is true, what provoked the continuing increase of total debt from the early 1980s onwards, an increase confirming "state hypertrophy" in Greece according to some academic analyses?

The restrictive policy implemented in the early 1990s slightly reduced the PSBR but massively increased total debt (table 2).

Table 3. Greek Public Expenditure as a Percentage of GDP

	1981	1988	1990	1992
Interest	—	8.56	11.91	9.92
Amortization	—	2.03	3.36	12.35
Total	28.95	37.53	43.65	47.81
Primary expenditure	25.21	26.95	28.38	25.54

Source: Ministry of Finance (1992).

Table 4. Greek Public Revenues as a Percentage of GDP

	1981	1988	1990	1992
Indirect taxes	13.1	16.8	17.6	19.3
Direct taxes	6.1	6.9	7.7	7.9
Total tax revenues	19.3	23.8	25.3	27.2
Non-tax revenues	1.3	2.0	1.7	3.1
Total revenues	20.6	25.8	27.0	30.4

Source: Ministry of Finance (1992).

Looking further back, one can easily see that the source of the debt explosion during 1990–1993 was the significant increase in public expenditure (table 3). European Economy (1990) gives 46.2% of GDP as the average annual percentage of public expenditure during 1981–1990. Whichever source is closer to reality, it is clear that even 46.2% is lower than the average annual rate for the EU in the same period—namely, 48.0%. Furthermore, primary expenditure as a percentage of GDP remained relatively stable: starting at 25.21% in 1981, rising only to 28.38% in 1990, and dropping again to 25.54% in 1992. Thus the increase in public expenditure between 1981 and 1992 (legitimate according to European standards) was definitely not caused by new or added primary expenditures. Table 3 shows that the increase arose from the huge rise in combined interest and amortization payments, which went from 10.59% of GDP in 1988 to 22.27% in 1992. Also, as a percentage of public expenditure alone, combined payments for interest and amortization rose from 17.5% in 1988 to 42.2% in 1992 (Epilogi 1993:24). In order to counterbalance the large increase in interest payments, there was (again contrary to what is commonly believed) a decrease in the share of wages and pensions in GDP—from 14.07% of GDP in 1989 to 12.45% in 1992.

To cover the increasing deficit, policy makers during 1990-1993 recommended a large increase in taxes. Total tax revenues rose from 23.8% of GDP in 1988 to 27.2% in 1992 (table 4). It is worth mentioning that this rise in public revenue came mainly from indirect taxes (OECD

1993a:50). Direct taxes—on deposit interest—produced only a 1% increase during this period (Ministry of Finance 1992); indeed, the corporate tax was reduced to 35% (Barclays Bank 1993:6). Despite the increase in indirect taxes, Greece's level—19.1% of GDP for 1991 (AGI 1992:12–13)—remained near that of the EU (19.0%), although an important increase in indirect taxation resulting from policy decisions made in August 1992 should have increased the figure slightly.

The above data show beyond a doubt that Greece's deficit should be largely attributed to two factors: (1) the low level of state revenue resulting mainly from low direct taxation especially on income and profits—state revenue in Greece from taxation on income and profits constitutes only 6.5% of GDP while the corresponding OECD figure is 14.5% (OECD 1990:141), and (2) the large increase of expenditure for debt service. Furthermore, if we add to the official GDP the one that is produced in the so-called παραοικονομία or "black economy"—estimated around 30% (Pavlopoulos 1987) or even 50% of the official GDP according to Angelopoulos (1992) and Barclays Bank (1993:6)—, then state expenditure and revenue as a percentage of GDP are much lower than the official numbers indicate.

Finally, it is worth mentioning that some studies indicate that this percentage would be even less if we estimated the inflation-adjusted PSBR (Spraos 1991) or if we modified calculations by excluding state guarantees for private sector borrowing or by including state-owned corporation deposits in banks (Arsenis 1990; Vavouras 1992; Heilbroner and Bernstein 1989; Kuttner 1992).

Returning to the main matter under discussion, the assessment of the conservative monetarist policy implemented during 1990–1993, we can now definitely maintain that the conservatives' diagnosis was wrong. It is impossible to argue that macroeconomic imbalances stem either from excess demand or from a state that is hypertrophic in size and intervention. The deficit, since it is fed mainly by interest and amortization payments (on the expenditure side) and by the state's weakness, inability, and unwillingness to impose and collect direct taxes (on the revenue side), should not be considered structural.

On the expenditure side, we observed that an ever increasing percentage goes for debt service while primary expenditure remains stable. As long as the real rate of interest paid by the state remains higher than the real increase in GDP, overall debt will keep increasing for the foreseeable future. Under these circumstances, it is estimated that large surpluses would be needed in the primary budget from now on in order to cover every "new" deficit coming from the deduction of real interest rate payments from the increase in real GDP. But the effect of raising indirect taxes as well as of efforts to cut spending in order to

achieve a surplus in the primary budget, excluding interest payments, is to subtract income from businesses and consumers, further reducing purchasing power, profitability, consumer spending, and investment (Galbraith 1993). Besides, interest rates are kept artificially high not only in order to attract capital and compensate for low state revenue but also in order to prepare the national currency to enter the European Exchange Rate Mechanism (ERM) and to keep up with Maastricht obligations regarding the establishment of a common European currency (EURO). The latter is considered the best antidote to inflation expectations.

First of all, a high degree of exchange rate fixity requires correspondingly high levels of real interest rates, which further speeds up the process of debt accumulation both directly and indirectly—directly, by increasing the interest payments on debt; indirectly, by reducing the demand for high-powered money and the growth rate of output (Papademos 1993:153–154). Hence this policy keeps the deficit at high levels and balloons debt while, at the same time, high interest rates hinder the real economy and bring on economic inertia since the increase in GDP cannot counterbalance high interest rate payments. Moreover, this results in an increase in the average rate of state services in order to cover the deficit, leading to an increase in prices and inflation. Inflation in 1993 remained around 15%, with every possibility of reduction usually being overturned by a need to increase taxes in order to counterbalance an unexpectedly high budget deficit (for example, taxes rose from 22.3% of GDP in 1989 to 27.2% of GDP in 1992). Nor is the fight against inflation helped by keeping the national currency "hard," since a "hard currency" policy weakens the trade balance. From a deficit of 211.9% of GDP in 1988, the non-oil trade balance worsened to 215.8% in 1992 (OECD 1993a:71), and deterioration continues. When the trade deficit grows, the "artificial" nominal drachma parity is seriously undermined and attitudes toward the national currency are dominated by the performance and prospects of the current account. Then, real parity falls off owing to growing trade deficits, reinforcing market speculation over the national currency and keeping inflation at a high level, despite the fact that the economy is in deep recession. This policy, combined with the excess disabsorption created by highly restricting domestic demand, has even more catastrophic results on the real (industrial) economy. The fall in domestic demand reduces the size of the domestic market, diminishing economies of scale for businesses, increasing the per unit cost, and boosting inflation once again. Even businesses with great potential always find it more difficult to compete in the international market when imports are subsidized via the undervaluation of foreign currencies while, at the

Table 5. Gross Private Investments*

Year	Drachmas (millions)
1985	56000
1989	64027
1990	73412
1991	65943
1992	64803

Source: OECD (1993a:104).
* In constant drachmas.

same time, exports are taxed by an "expensive drachma." As a result, the only way they find to restore competitiveness is through the "low road restoration of profits" (Harrison and Bluestone 1988, 1990) based on a low-wage labor force. This restores competitiveness on a short-term basis but definitely undermines it in the long run by lowering investments and preventing technological change (Cohen and Zysman 1987; Pelagidis 1989, 1993, 1997). It is estimated that Greek profitability has increased as much as 80% since 1990 (Barclays Bank 1993:3) as a result solely of further wage cuts. Yet, contrary to what conservative policy makers expected, this has not caused a corresponding increase in investment rates (table 5).

The sharp increase in unemployment to 11% was equally damaging to the economy. Not only does high unemployment undermine social justice, destroy societal cohesion, and hamper the conditions needed for growth in productivity, it also "represents" lost potential output. According to Eisner (1993), high unemployment, besides wasting resources, adds to the deficit in the short term; then the amount grows over time as the increased deficit adds more to the debt service—i.e., to interest payments in the future. Furthermore, a loss of potential output means a loss of potential investment that otherwise would increase productivity and competitiveness, the side-effect of which would be to decrease the debt and deficit by enlarging and deepening the economy's taxable "base" and by increasing GDP. In short, a so-called "full employment budget" would have a lower potential deficit. As a result, we can say that today's fiscal policy is even more restrictive than it appears to be when conventional calculations are employed.

On the other hand, the healthy part of Greek industry enjoys a profit margin exceeding 60%, which is extremely high, the relevant percent in the OECD and the G7 countries being around 44% (OECD 1989:124). Since 1990, there has also been a sharp recovery in Greek profitability, with a rise of some 80%, as mentioned above (Barclays Bank 1993:3). Direct state aid to manufacturing as a percent of value

Table 6. Sources of PSBR Financing in Greece: Share by Percentage

	1989	1990	1991	1992*
Internal borrowing:				
state bonds purchased				
by banks	42.2	16.1	1.8	227.9
by individuals & companies	18.9	43.1	68.0	93.7
other borrowing				
by commercial banks	15.8	13.7	12.7	22.8
by Bank of Greece	10.0	15.0	5.0	32.8
Total internal borrowing	86.9	87.9	87.5	95.9
External borrowing	13.1	12.1	12.5	4.1
Total	100.0	100.0	100.0	100.0

Source: Central Bank of Greece (1993:61).
*January–September, predictions

added was around 20% in Greece, while in the EU it was lower than 4% during the 1986–1990 period (OECD 1993a:16). All these factors considered together—low taxation on businesses, low state revenues owing to low taxation on income and revenue, low investment rates, and high public deficits—constitute a substantial state contribution to the private economy. This "hidden" state back-up to individuals as well as to industrial competitiveness in general, together with the state's minimal intervention in the economy signifies in my view a "state atrophy" in Greece. It should be emphasized at this point that the high interest paid by the state in order to attract funds to counterbalance diminished budget revenues is in fact the way to nourish private profits and to constitute the "crucial link" between the state and the private sector. This unique manner of state contribution now replaces the "old road" by which the Greek state supported private revenue in Greece before the country's accession to the EU—namely, high state subsidies and general protectionism. Significantly, however, this situation produces a vicious circle of financial flow between state borrowings from the private economy through bonds, on the one hand, and state back-payments to the private economy through high interest rates—a situation favoring capital that is speculative in nature. This capital, instead of being invested productively, contributes to the well-being of a "neo-compradoric" class that seems to live on interest revenue alone and at the expense not only of non-privileged social classes but also of industrial production in general.

The economy's most serious problem seems to be the increasing share of state bond purchases by individuals and companies, which reached its peak in 1992 (table 6).

This table shows that funds, instead of being directed to real investments in machinery and equipment—i.e., investments that increase productivity and competitiveness—, go to the purchase of state bonds simply because they are more profitable. Thus industries, "learning" to rely more on low wages, avoid investments in new technology and invest more in state bonds (Sweezy and Magdoff 1987; Cohen and Zysman 1987; Harrison and Bluestone 1988; Pelagidis 1993).

Policy guidelines and conclusions

The main purpose of economic policy is to intervene at the source of an economic problem. It is unfortunate that when a new policy was implemented in Greece during the crucial years 1990–1993 the rule of optimal intervention was distorted by a policy that diminished domestic demand and created excess disabsorption when the source of the problem was located on the supply side. Deficit reduction was the wrong goal, not because deficit reduction is unimportant but because in this case it was not the main issue. After four years (1990–1993) of "wild monetarism," a slight decrease in the budget and current account deficit, together with some marginal decrease in the inflation rate since 1990 (in 1988 it was around 13%) constituted improvements that were only slight and that, furthermore, occurred at the expense of the country's industrial base.

The current account was improved from 24.7 of GDP in 1989 and 25.4% in 1990 to 22.7% in 1992, although it stood at only 21.8% in 1988. However, as we have already observed, there was deterioration in the non-oil trade balance, which is the main reflection of competitiveness within the current account (terms of trade non-included). From 211.9% of GDP in 1988, the negative non-oil trade balance fell to 215.0% in 1991 and to 215.8% in 1992 (OECD 1993a:71). This deterioration continues, owing mainly to the government's "hard currency" policy; indeed, deterioration would be even worse if imports were not diminished by a restrictive policy concerning domestic demand. However, one can overvalue a first time, one can overvalue a bit more a second time, but one cannot overvalue indefinitely without damaging the sphere of production (Spraos 1991). Under a "hard currency" regime, it is indeed entirely possible that production could be so weak after a long period of recession that it could not respond to any increase in demand. In that case, the most probable effect is that demand would be directed mainly to imports, worsening the trade balance even more. Authors who support a "hard currency" policy believe that any other policy-mix will cause inflation to increase again, making it impossible to lower interest rates.

At this point I must mention two things concerning currency. (1) When currency is allowed to slide according to market signals, it is entirely possible that foreign competitors will keep prices down in order not to lose their domestic market share. (2) When currency is allowed to find its true equivalence in the market, exports become more competitive and, as a consequence, production grows and the trade balance improves. In addition, if national competitiveness is to be efficiently supported, exchange rate parity should follow more closely the currency fluctuations of countries such as Spain, Portugal, and Ireland that directly compete with Greece in various products. Therefore, although exchange rate policy is a very delicate and sensitive matter requiring careful moves, I propose for the time being a "crawling peg" policy according to market signals.

Regarding the budget deficit, it should be clear from my analysis that if the state continues to pay real interest rates that exceed real GDP growth, any slight deficit decrease will be overbalanced by a deterioration in the total debt ratio. My analysis proves that a large part of the deficit is traceable directly to the slow economy. Indeed, any effort to reduce primary expenditures today would make the current economic stagnation even worse. What is needed is an effort to redirect public expenditure to activities that stimulate investment.

The policy followed after 1990 not only failed to stimulate investment by lowering interest rates; it also retarded investment by dampening the growth of demand. It proved counterproductive because its focus was misplaced on (dis)absorption to the neglect of competitiveness, which my analysis shows to be the real issue at stake. Productivity decreased; so did technologically based restructuring. The Greek economy, instead of converging with the nominal targets of the Maastricht Treaty, in fact diverged from them (Pelagidis 1996).

What is needed to counter the demoralizing economic and social climate is a correct diagnosis, one that puts problems into proper perspective. First of all, a permanent and sustainable increase of GDP is needed to create a stable economic environment. The socialist government's top priority should be to reinforce the economy's competitiveness. Enhanced competitiveness will be immediately reflected in a positive way in the balance of payments by stabilizing the currency rate. Emphasis should be placed on increasing investment in plant and equipment since this will certainly lead to higher rates of future productivity growth. Companies desist from investment activities today only partially because of high interest rates. In many countries, interest rates are kept quite low in order to encourage productive investment, yet the rate of investment still fails to reach the target. On the contrary,

of cardinal importance are expectations for future profits from a steady, permanent increase in demand that is proportionate to GDP.

Thus, restoring economic activity should be the government's first priority in countering the persisting economic downturn. To overcome the current crisis and stimulate recovery, the government must reduce the risks facing individual firms as they increase expenditure. Within this context, a general tax-based expansion is less sustainable because money in an open economy seems to be attracted more to imports and consumer spending, creating only short-term, vulnerable jobs and producing long-term stagnation. It may appear paradoxical (especially to conservative intellectuals, right-wing policy makers, and "deficit hawks") that in order to reduce the deficit and the debt, we should first slightly increase the deficit and debt by a stimulus package directed at public investment, and by spending on incentives to spur private investment in the intangible, high-yield areas of training, education, and research in order to assist the economy to reach the needed growth trajectory (Magaziner and Reich 1982; Reich 1992a; Wall Street Journal 1992). Such measures would stimulate demand, reduce unemployment, raise the GDP, and very likely raise private investment also. Recent studies that focus on these supply-side measures indicate that infrastructure spending both increases productivity directly and stimulates private investment (Baker and Schafer 1993; Aschauer 1990). In addition, Tobin (1992, 1993) argues that we should not be afraid to increase the deficit for investment purposes and thereby to bring aggregate demand to a level that will permit full employment. Investment tax credits and spending on infrastructure constitute the two-track growth path for sustainable development (Blinder 1992).

It is most fortunate that Greece has the chance today to increase investment spending without increasing public debt at the same time. The Delors II financial transfers from the European Union (1994–1999) allow Greece mainly to increase infrastructure spending without adding substantially to public debt.

Emphasis should also be placed on microeconomic issues with especial attention given to both "horizontal" and "vertical" industrial policy. As far as the former is concerned, it should be repeated that general infrastructure investment will generate increased productivity in the private sector. For example, recent evidence shows that the Japanese have the highest public-sector investment rate and, at the same time, a private-sector investment rate which also exceeds that of other nations (Ferleger and Mandle 1993). Similarly, it has been shown by Aschauer (1990) and numerous other scholars that the higher the public investment in infrastructure, the higher the productivity a nation enjoys, while

any decline in public investment seems to be accompanied by a slowdown and a period of recession. There is also evidence that no positive relation exists between total factor productivity and an increase in tax revenue, especially revenue that comes from personal and corporate income (Ferleger and Mandle 1993). Japan is again an outstanding example.

On the other hand, industrial targeting criteria (vertical measures) should be applied to enforce a country's comparative advantage and to redirect private expenditures toward investment-led purposes (Krugman 1984, 1991, 1992). Enhanced industrial competitiveness is likely to produce permanent improvement in the trade balance and, as a result, international confidence in the national currency, supporting currency stability.

The policy directions proposed by this paper are based on the view that, in order to break out of the vicious circle and to shift from speculative capital and generally unproductive activities to productive investment in the real economy, priority should be given to economic growth. Deficit reduction is only tangentially related. A large deficit may retard growth in the long run, but it is not the largest hindrance to growth (Reich 1992a, 1992b). Nor is it wise to try to depress inflation at any cost in a slump era. The Greek economy, contrary to what some believe, neither was nor is on the verge of overheating. If and when this situation changes, that will be the time to press gently on the brakes. But that time is certainly not today. If the PASOK government continues to implement conservative prescriptions, the future results will be similar to those of the 1990–1993 period.

NOTES

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