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Statement by the Hon. YANNOS PAPANTONIOU ,
Governor of the Bank for GREECE ,
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THE WORLD ECONOMIC SITUATION AND THE
GREEK ECONOMY

***Speech by Mr. Yannis Papantoniou,
Minister of National Economy and Finance
of the Hellenic Republic,
at the IMF - World Bank Annual Meeting,
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The current turmoil in world financial markets was to a large extent unanticipated and initially underestimated. The chain reaction that followed the financial disturbance in Thailand a year ago revealed certain important negative aspects of globalisation. The rules concerning the prudential supervision of financial institutions, including mutual and hedge funds, and the transparency of their operations proved to be insufficient in either predicting or preventing the coming financial turmoil. The spread of financial contagion that followed the massive devaluation of several Asian countries' currencies indicates the difficulty of the international monetary system to cope with global capital flows of an increasing scale. At the same time, our limited experience in dealing with a less 'traditional' turmoil which is not related with current account problems, led us to an initial underestimation of its effects on the world economy. There are some important lessons to be drawn from the recent instability of the international economic system:

- We must confront with the fact that since the international economic system is vulnerable to crises, domestic policies should take into account the uncertainty and volatility of the economic environment. Coping with the instability of the global economy requires credible and consistent policies. In this

context, greater transparency is a prerequisite, especially for all financial institutions.

- The domino effect of financial disturbances tends to become stronger as a result of the growing interdependence of national economies, the increase in cross-border capital flows and the rapid technological progress. As the cost of a financial disturbance increases, so does the benefit of preventing it. In that respect, we must carefully reflect on ways to strengthen and reform the prudential supervision of the international financial system, including the imposition of new international legislation if this is deemed necessary.
- Not all countries affected by a financial turmoil necessarily follow bad economic policies. Good economic fundamentals and sound policies is a necessary but not a sufficient condition for protecting an economy from a financial contagion effect.
- In most cases, however, the economies that suffered from the current financial disturbances were facing deep structural weaknesses that need time to be cured. In the short term, it is the task of the international monetary system to alleviate the effects and the spread of the crisis. To that end, more resources for the IMF are essential. This is a matter of utmost urgency.
- According to many commentators, the rather limited success of the IMF in managing the current crisis has created certain credibility problems that weaken the impact of its intervention on risk perception. In order to reinforce the central role of the IMF in the smooth functioning of the international monetary system, we should carefully reflect on whether it is adequately designed in order to cope with the current economic environment. Apart from enhancing its resources, strengthening its political governance by transforming the Interim Committee into a Council would significantly improve the credibility and efficiency of the Fund.
- The stability of the international monetary system is a public good and, as such, it cannot be established by market forces alone. Better coordination among governments, international financial institutions and the private sector are essential.

The launch of the single currency in Europe, the Euro, will improve the stability of the economic environment for Member States. On the one hand, the convergence process of Member States led to an improvement of their fundamentals. On the other hand, the size and compactness of the euro area will limit the Member States exposure to financial turmoil. Economic policy coordination within the framework of the Stability and Growth Pact, combined with the price stability objective of the ECB, will further reinforce the euro. The emergence of a new strong international currency will contribute to the stability of the international monetary system. The increased responsibility of the EU for the smooth functioning of the international monetary system requires that its role in crisis management is enhanced.

The impact of the international crisis on the Greek economy is limited. Greek exports to all those countries hit by the crisis account for just 0.2% of GDP and there is virtually no exposure of our banking system. Moreover, any loss in external demand is being compensated by domestic demand which is driven by the high level of investment growth.

The more or less symmetric effects of the current crisis on Greece compared to the rest of the EU countries indicate the upgrading of Greece from an emerging to a pre-euro economy. The markets' perception is based on the substantial progress made towards convergence with the EU as well as on the successful participation of the Drachma in the ERM since March 16. As it was announced in the September Informal ECOFIN Council, the Greek Drachma will also participate in ERM2 as from 1st January 1999.

The performance of the Greek economy over the 1994-98 period indicates rapid convergence toward the European Union average economic performance in both nominal and real terms. Greece aims at joining Economic and Monetary Union by 1.1.2001.

The fiscal consolidation effort which begun in 1994 resulted in gradually reducing the size of the general government's deficit by almost 11 percentage units of GDP by 1998. The size of fiscal consolidation achieved is almost three times larger to that

accomplished by the rest of the EU member countries over the same period. The general government deficit in Greece is estimated at 2.4% of GDP in 1998.

At the public debt front, the generation of large primary surpluses in the state budget since 1994 enabled the debt ratio to decline from 111.6% of GDP in 1993 to 106,7 % in 1998. The downward trend in the debt ratio is set to accelerate in the coming years.

The progress achieved so far in combating inflation has also proved remarkable. Inflation has been reduced by 9.6 percentage points from 14.4% in 1993 to an estimated 4.8% in 1998.

The overall economic policy stance in 1999 will remain tight. In particular, fiscal consolidation will continue with the general government deficit set at a lower level than the 2.1% of GDP envisaged in the convergence programme. Budget savings will be mainly achieved by containing public expenditure.

The third stage of EMU is not solely about nominal convergence. What matters most over the longer term is real convergence. Over the eighties and early nineties Greece has experienced stagnant and even negative rates of growth. Starting in 1994, however, this retarding process was reversed and the country has already entered a period of higher growth leading to real convergence with EU. Growth rates of the order of 3.5% to 4% are projected for the years ahead, based on fiscal discipline, price stability, a high investment ratio and structural reform. In particular, Greece is experiencing very high rates of investment growth with beneficial effects on employment and productivity. Productivity is further reinforced by the introduction of flexibility enhancing labour market reforms, the implementation of an ambitious privatisation programme, the restructuring of loss making public enterprises as well as the improvement of public sector's efficiency, especially in health, education and employment policies.

Our Government is committed to continue pursuing policies that favour stability, growth and employment while reinforcing social cohesion. In so doing we prepare Greece to face successfully the

challenges of the 21st century in the context of a unified Europe and a dynamic global economy.