Panayotis Thomopoulos: Post-Olympic Greece 2004 - infrastructural development and financial innovation

Speech by Mr Panayotis Thomopoulos, Deputy Governor of the Bank of Greece, at the Euromoney Conferences, Athens, 24 November 2004.

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Ladies and Gentlemen,

It is a rare opportunity to be able to address a distinguished audience as this one on such a topical issue as the future of Greece in the post-Olympics era. In everyone's mind there is the question whether Greece can sustain the relatively high level of growth achieved in recent years now that the demand stimulus coming from the preparations for the Olympics has come to an end. This is an important change for Greece indeed, coming on top of all the difficulties faced by the world economy such as the oil shock, the geopolitical uncertainties and the threat of a disorderly resolution of global imbalances. Trying to forecast the future is always a perilous activity and under today's circumstances one might be inclined to take a pessimistic view.

I would like to diverge from the pessimists and I will use my time to explain why Greece can continue on a path of strong growth if we can address the forthcoming challenges by adopting sound and market-friendly policies. To use a sporting metaphor, in the 1960s and 1970s Greece won the European gold medal with the fastest GDP growth, afterwards our successive coaches failed, but again since 1994 we came under the discipline of an excellent coach, the German inspired Maastricht Treaty and finally in 2004 we won the European Champion Football Cup (EURO). Indeed, Greece's annual rate of GDP growth of 3.7% between 1997 and 2004 was the second highest in the EU, after that of Ireland, and one-half bigger than that of the euro area. I believe that we can retain again a position near the top if we put our best effort to it.

Year 2005 will be a difficult one, as the necessary fiscal adjustment and high oil prices will constrain growth. However, over the medium-term, I do not see a danger of a severe slowdown or recession. Of course, we cannot continue to grow for extended periods at rates above 4%, so some deceleration is to be expected and may do us some good by helping contain inflationary pressures. Our growth rate may regress back to our long-term potential, which I estimate to be around 3½%. I want to note that the OECD in its medium-term scenario has recently reached the same broad conclusion - estimating an average growth rate of about 3½% per annum up to the end of this decade, which is some 1?% percentage point higher than the scenario presented for the euro area as a whole. Of course, if the international economic environment improves, especially EU growth turns out to be much higher than 2% Greece will also reach a higher growth path. On the demand side, both private consumption and investment should continue to be strong. The continuation of the Community support programmes, though on a declining trend, will help support public and private investment for quite a few more years. The on going investment in infrastructure, especially in the peripheral regions, will continue to underpin a fast rate of productivity growth, as the Olympics 2004-related investment has done for the Athens area. Businessmen and ordinary citizens can at last appreciate the fruits of all this endeavour and forget the discomfort caused as the various works were heading to completion, and I am sure many of our visitors today benefit from the renovated Athens area. The list of projects underway or planned, eg Egnatia highway, highway links with our northern neighbours and beyond, are essential and will provide the necessary complement to private investment, while business investment should also respond to the announced tax relief.

Despite fears to the contrary, I do not see a danger for private consumption. Private indebtedness has indeed increased fast but its level is still quite low by European standards. Compared to the increase in the private wealth of Greek households, reflecting both the rise in asset prices and in the housing stock, the net private indebtedness has not increased much. Recently, we have started seeing a gentle deceleration of credit growth, which, I believe, is a sign of responsible behavior both by borrowers and banks. Despite horror stories in the newspapers, we are far from the position where indebtedness would threaten growth. As long as growth remains robust, households will see no reason to cut back their consumption habits drastically, although temporary minor adjustments cannot be ruled out. Indeed, in a phase of disinflation, as the one expected over the next couple of years with the aim to narrow the inflation differential vis-a-vis the euro area, a small adjustment in consumption trends may take place.

The external sector should be able to assume a more prominent role. After a couple of disappointing years, there are already some indications that tourism is picking up, helped by the positive image of Greece projected by the Olympics and assisted by the improvement in transport infrastructure and the upgrading of hotel and tourist resorts in general. Moreover, the price fever associated with the Olympics seems to have subsided and hoteliers appear to be scaling down prices to more competitive levels, while bookings for 2005 are on the rise. In general, tourism will remain a buoyant source of growth for the Greek economy, especially if the government decides to allow shops to stay open all week-afternoons and to extend the opening hours of the archaeological sites and museums up to late afternoon so as to make again our city centres attractive. The authorities should have made a cost/benefit analysis in order to assess the significant overall economic gains that could be derived if, as in the rest of the civilised world, our museums and archaeological sites were open also in the afternoons.

Shipping goes through an upswing, and the related balance of payments receipts will probably reach a record €12 billion in 2004, exceeding by a wide margin travel receipts, while the immediate prospects for shipping remain favourable. However, we have to note that although shipping may this year become the largest net export earner, its multiplier effect on the rest of the economy is smaller than that of tourism. And this because it employs about 80% fewer people than tourism and, owing to the high revenue per capita in shipping, the saving rate is much higher and correspondingly less is spent on home products. The emerging upturn in Europe will also help our exports of goods and services. On the supply side, the huge investments in recent years are now starting to bear fruit, while we should not forget the contribution of immigrants to both supply and demand. Immigrants have become an essential part of our production system, and - I would also add - of our society, while, at the same time, they are becoming a unique economic and political link with our neighbouring countries, from which they originate. They undoubtedly help the integration of the Balkan countries and contribute to the economic development of the wider region.

Much has been said about the fact that Greece is a laggard in implementing the Lisbon strategy. This is partially true, but look at it from the other side, there is much more we can still achieve by embarking on the implementation of the Lisbon agenda. This should be a priority for policy makers. Liberalising the labor and product markets can bring benefits even in the short-run. Allowing greater labor flexibility can induce entrepreneurs and, especially, foreign investors to enter the market. Removing oligopolistic practices can be a spur to growth and help contain prices. Flexibility in labour market does not mean less protection but more protection to all workers. The strict labour laws, which are, sometimes, unfortunately, interpreted even stricter by judges, is an important factor behind the big underground economy. Unregistered labour has no job protection but is also less well paid than registered workers. The insider/outsider issue, which has reached big proportions in Greece, is also an important factor behind the recorded high unemployment rate, especially affecting young people. The relatively small proportion of registered workers also undermines the capacity of the pension system to pay in the future the full pension entitlements to to-days working population. Accordingly, the insiders may not even themselves be so well off at the end of the day as they think. More flexible labour laws which will bring to the surface the unregistered labour and the concomitant increase in social security contributions will also help to establish a sound pension system delivering all its commitments. Accordingly, it is up to the authorities to move in the right direction and also benefit from the reform dividend.

One thing that should be clear to all is that the future will be different from the past. Growth in recent years has been based on domestic demand, fuelled by construction, overall easy monetary conditions and large deficits, as are now recorded. These favourable factors will play a smaller role in future, as the fiscal position moves gradually to balance or surplus and real interest rates increase, reflecting a decline of inflation and a rise in the nominal interest rate, if the ECB changes its monetary policy stance. So we have to give more prominence to external sources of growth and structural measures. We must adopt an “extrovert” policy that gives priority to improving our role in the world economy. Sometimes I hear arguments for import substitution as a source of growth. Let us be frank; for a small, country-based economy, as the Greek one, only firms which can also export can have the critical mass of production to remain viable in a highly competitive global economy. It is better to delete import-substitution from the Greek vocabulary. In reshaping our economy, we should focus on areas where we already enjoy a comparative advantage, and by this I have mainly services in mind. This does not mean that we should neglect agriculture and industry. I simply want to say that these two sectors have ceased to be pillars of growth.

The Greek agricultural sector has followed the international trend and has now shrunk to less than 7% of GDP, and will probably further decline close to the European average. Manufacturing's share in GDP has stagnated and may from now on follow a slow downward trend. We should not be fooled that these trends can be reversed, nor should we try to engage in interventions that distort markets and incentives. In particular, the ongoing reforms of the Common Agricultural Policy and the final liberalisation of textiles trade next year will put further pressure on these sectors. Greek farmers and entrepreneurs can certainly improve the quality of their products and move to higher value-added product lines. They should use the window of opportunity offered now by the unusually low interest rates to embark on the necessary investments. But it should be clear that Greece is now an advanced economy, with a high per capita income by international standards, and cannot expect to remain competitive in labour-intensive and low value-added industries. The high productivity growth of the recent past has transformed the Greek economy but has also brought along new challenges. In a recent study by the OECD in the 10-year period up to 2003, out of the 30 OECD countries, Greece ranked fifth, after Ireland, Korea, Luxembourg and the Czech Republic, in the productivity growth table, with a 2.8% annual rate of increase in labour productivity, some 40% faster than the OECD average.

We should invest in quality and develop a distinctive image of Greek products. We should also exploit our geographic location and the traditional orientation of our trade toward countries in South-Eastern Europe and the Middle East. We have long complained that we were in a difficult geopolitical position, reflecting the condition of our neighbors, but now we can enjoy that our neighbors in South-East Europe and the Middle East are becoming market economies and are growing fast. Our industry has been quick to seize on this opportunity and has re-oriented Greek exports toward this region, whose share of Greek exports has risen from less than 15% in early 1990s to about 25% last year. I was amazed to see that Bulgaria is now our fourth biggest customer, while Turkey has moved up to the sixth place.

Greece occupies a very advantageous geographical position; especially northern Greece with its port Thessaloniki is bound to become again the indispensable transit link for trade and travel for all the Balkan countries. FYROM has no other sea outlet, but Thessaloniki also is closer to Sofia than the Bulgarian ports in the Black Sea, and the same applies for large regions in South-East Romania, South Serbia etc. Companies established in these regions will find it more convenient to use Thessaloniki as a trading port than other sea outlets. Especially, if one takes into account the queuing time needed to cross the Bosphorus, the economic advantage of the Greek ports is more than evident. This will be even more so when the EU co-financed trans-European transport networks, opening up the Aegean ports to our northern neighbours and beyond, will reach a maturity phase towards the end of this decade. Can Thessaloniki become the Rotterdam of the Balkans? Keeping all proportions I would reply YES, and its expansion in recent years and especially after 2007 when the road linking Turkey to the West (the Egnatia highway) will have been finished is a guarantee that Thessaloniki along with Northern Greece will be restored to its past trading and economic glory, to say nothing about the fact that it is a very pleasant, in many respects more than Athens, city to live in.

Greece is in a special position in that its exports of services far exceed its exports of goods. In fact, our non-oil good exports are now somewhat less than tourism receipts and even less than those from shipping, while our total receipts from services cover more than four-fifths of our total non-energy good imports. Many foreign observers indicate, as a source of concern, Greece's trade imbalance but they forget that -in the world we live in- services are growing faster. We should build on our success in these areas. It is well known that Greece is a major world power in shipping and by far the most important shipping nation in the European Union and, on the basis of new orders, it may increase even more its world market share over the medium term. For both economic and geopolitical reasons, Europe needs a strong merchant fleet, and here lies Greece's important contribution to the Union. Greece, with a shipping tradition of more than three thousand years, should maintain its comparative strength in this area both for its own benefits and the European Union's as a whole. Shipping is a sector subject to practically unhindered international competition; it is, therefore, necessary not to impose on it measures and regulations that could impair its competitiveness, apart from those required for environmental reasons. We should also look at ways to enhance the role of Piraeus as an international shipping center.

From my previous remarks, it becomes clear that Greece can and should play a significant role as a bridge between the industrial countries of Europe on the one hand and South East-Europe and the Middle East on the other. We should aim to attract direct investment from foreigners, who will use Greece as their regional headquarters and for their high-end activities, while the more labor-intensive phases of production will be located in neighbouring countries with more abundant labor supply. Greece is well placed for this role. Our labor force is well educated, with a significant part of it having a working knowledge of a foreign language. Both the quality of life and infrastructure have improved enormously in the last few years, especially in the Athens region as a result of the major works undertaken for the Olympics, and now, as the government has announced, the attention will be directed to Thessaloniki.

Undoubtedly, many other countries in the region, notably Turkey, may aspire to do the same but I think we have the edge. Greece has an open society, accustomed to working within an international environment. Indeed, many Greeks have spent years abroad working or studying, and this is an asset for them and for the country. Many have also ties to the countries of South East Europe and the former Soviet Union, as well as to Middle East countries where they had lived and whose languages and business environment they know. Don't forget that not so long ago more than 300,000 Greeks were living in Egypt. The other very important advantages often cited are related to Greece's membership of the EU for nearly a quarter of a century. Greece offers:

1. legal certainty, as the rules and laws it applies are the same or very similar to those in the other more industrialised EU countries;

2. macroeconomic stability and the strong currency of a euro area member;

3. a friendly business environment;

4. a resilient economy and society that have proved their worth under normal conditions but also in turbulent economic periods (e.g. oil shocks, speculative attacks against the drachma, abrupt rises and declines of the stock exchange that would have forced many other economies to bend on their knees).

5. a sound banking system, with an extended network in all the Balkan countries. Banking is the oiling mechanism of the capitalist systems and if the oil is not of a good quality sooner or later the engine will come to a stop. Turkey's banking crisis and the related foreign exchange crisis a few years ago is a reminder. From the early 1990s the Bank of Greece, as the supervisory authority, laid down the rules and brought pressure to bear for the modernization and strengthening of the banking sector. To-day we coordinate our efforts with the commercial banks to promote the necessary adjustments in line with Basel II. The new International Reporting Financial Standards and Accounting Standards, should make the banking system even more flexible, strengthen its capital base and improve its internal control and risk management systems. Given also the significant presence of Greek banks in the Balkan countries the Bank of Greece has signed Memoranda of Understanding for cooperation with the supervisory authorities of these countries.

Greek firms have also risen to the task of responding to globalisation not by adopting a defensive strategy, but by embracing globalisation themselves. There have been very significant direct investments by Greek firms abroad, especially in the Balkans. This is particularly evident in the financial sector, where Greek banks now occupy top positions in all our neighboring countries.

About 5,000 Greek firms, mostly small to medium-size enterprises but also a few large ones, are now operating in the Balkan countries and Greece is between the three biggest investors in the region. This inevitably entails some delocalisation of part of Greece's manufacturing and trading units. However, so long as they retain in Greece their high value added activities (their headquarters, their commercial and their research activities etc), this delocalisation in the long run helps both the host and the home country economy. I always try to give an example: The UK lost some 3.5 million industrial jobs (50% decrease) between 1978 and 2003 and gained over this period some 3 million jobs in the financial sector (100% increase); as the value added in the latter may be 4 times higher than in industry, the total gain for the economy has been enormous and is the main explanation of the success growth story of the UK in the last couple of decades. I have repeatedly stressed the example of London as a financial center, and all factors favours Athens for becoming a regional financial center, not only for the Balkans but even for countries further away. Likewise, Athens and Thessaloniki can become trading centers for companies operating in the wider area.

Attracting foreign firms should form a central part of our future strategy. In the foreign direct investment league, especially in manufacturing, Greece unfortunately comes close to the bottom in Europe. But this hides the fact that many foreign firms, either completely on their own or in alliances with Greek firms, operate in Greece, but usually under the trademark of the original Greek owner, even if he has died long ago. This special partnership has to develop further, because each side complements the other and cross border alliances are an essential support for growth, especially in the case of smaller countries. Though, as I said, even if up to now Greece's performance in the area of foreign direct investments has been quite disappointing, I believe things are about to change. After many years of sustained effort there is now a new, pro-business mentality, as evidenced by the wide political consensus on the need to further promote market-friendly reforms and the recent lowering of corporate taxation is in the right direction. Above all, we need to reduce bureaucracy and combat decisively all cases of improper practices. On the latter issue, we should adopt a policy of "zero tolerance." We should establish clear and simple rules for the conduct of business, which should not be amenable to interference from politicians and public servants. The "rules of the game" should be transparent and the same for all.

In a recent OECD study on the business sector, Greece, though not the worst performer, unfortunately ranks among the countries with most bureaucratic impediments: large number of licenses and certificates required from different authorities both in order to open a new business but also even when operating for years, big delays in issuing them, lengthy judicial procedures, retroactive tax controls, sometimes going back to more than 10 years etc. I believe that, if the authorities tackle in an efficient and pro-business manner these problems and simplify the system, a big obstacle to success will have been overcome. To this end, the authorities should not weigh the supposed political cost, since over the medium-term the political cost of inertia is much greater. Even if some mistakes are inevitably made when trying to change long established practices, reform always pays in the medium to long run. I don't underestimate the cost, since reforms meet resistance from the few but well-organised bodies that have every interest in perpetuating the anomalies. Against this resistance, those who are expected to benefit from the reforms are not so militant and organized, since they represent a broad spectrum of people but lower benefits per person. Besides, benefits from reforms are not always immediately visible and thus those expected to benefit do not appear to be as combative as the opponents of reforms.

Greece's post Olympic advantage lies in services. Especially I see Greece as the main provider of modern and high value-added services in the Balkans and even beyond. I identified tourism, which moreover, can now draw significant benefits by using the Olympic infrastructure for the organisation of big international conferences and other events. The expansion of shipping and related activities, the development of a regional financial sector in Greece, the establishment of foreign trading companies should henceforth also be the pillars of a fast rate of growth. Last but not least the proposed opening of higher education to private funded institutions should lead to an improvement of the overall educational standards, while bringing to Greece foreign students from the wider region. In addition to the export earnings, a big proportion of foreign students will stay in the country and will instill dynamism to the economy, as well as they will strengthen the links between Greece and the countries of their origin and raise Greece's position in the world.

To sum up, I see the forces that have sustained Greek growth until recently (namely fiscal stimuli, unprecedented low real interest rates and significant EU co-financed infrastructure projects) will weaken slowly and should be replaced by new sources of growth: a more extrovert business sector, which is already starting to reap the benefit of its recent investments abroad, an administrative machinery friendly to entrepreneurship and lower taxation, as well as greater flexibility in the labour and product markets. All these factors can underpin a continuing high rate of productivity growth in the years to come.