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## INTELLIGENCE BRIEF

RECENT STRAINS IN THE GREEK ECONOMY  
AND THE SHORT-TERM OUTLOOK

DIRECTORATE OF INTELLIGENCE  
Office of Research and Reports

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RECENT STRAINS IN THE GREEK ECONOMY  
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Soon after becoming Premier, George Papandreou began to fulfill his promise, often repeated during the election campaign, to bring about a more equitable distribution of the nation's income. He used receipts from taxes on middle and upper income groups to subsidize farmers and other rural groups. Because expenditures exceeded tax receipts, it became necessary for the government to increase its rate of borrowing. These fiscal policies resulted in increases in both consumer demand and the supply of money. That prices did not respond upward was due largely to the safety valve provided by increased imports. The increased pressure was reflected, however, through the balance-of-payments accounts in a serious outflow of foreign reserves -- an outflow which probably was aggravated by the summer political crisis. The drop in foreign reserves, although serious, is not yet dangerous; the current level of reserves still provides a buffer against a balance-of-payments crisis. Officials in the Stephanopoulos government have expressed willingness to restore balance to government fiscal policies, and, if the new government is able to bring about some measure of political stability, a gradual improvement in the Greek economy may take place.

1. Government Budgets

Receipts and expenditures of the government of Greece are projected and recorded in two budgets: a regular budget, which contains current items, and an investment budget. Prior to Papandreou's taking power in 1964, the regular budget was kept always in a substantial surplus. The surplus funds were transferred to the investment budget, where they were combined with revenues collected specifically for investment spending and with receipts from government borrowing.

Since 1963, regular budget expenditures have grown more rapidly than regular budget revenues, thereby causing a significant decline in the annual surplus, as shown in the following tabulation:

	Million US \$				
	1963	1964	1965	January -	January -
	<u>Actual</u>	<u>Actual</u>	<u>Budgeted</u>	May 1964	May 1965
				<u>Actual</u>	<u>Actual</u>
Regular budget					
Revenues	730	825	940	302	335
Expenditures	670	798	924	264	306
Regular budget surplus	60	26	16	38	29

The increase in expenditures during 1964 was caused to some extent by new defense outlays associated with the Cyprus crisis. Far more important, however, were direct subsidies paid by the Papandreou government to farmers, cancellations of rural debt, and improvements in agricultural services -- which together accounted for roughly half (\$55 million) of new regular civil expenditures. An additional \$39 million went for increases in educational and social welfare programs, predominantly in rural areas. Farmers also benefited from government purchases of \$75 million of surplus crops, chiefly wheat and tobacco, bought at double their normal market price. These increased benefits to rural areas were financed mainly out of increased tax receipts from the cities, primarily receipts from luxury taxes, and constituted a deliberate redistribution of income.

Such trends continued under the 1965 budget. The budget calls for agricultural subsidies to increase by \$13 million and allocations for social welfare and education to be up \$102 million above those of 1964. Larger government purchases of surplus crops also are forecast. Furthermore, civil servants are to receive an increase of 7 percent in both salary and pension, costing \$30 million.

## 2. Government Borrowing

Declining regular budget surpluses have made it necessary for the government to borrow increasingly to cover expenditures in the investment budget, as can be seen in the following tabulation of the total outstanding end-of-year debt of the central government:

	Million US \$		
	<u>1963</u>	<u>1964</u>	<u>1965</u> <u>(Estimated)</u>
Domestic debt	<u>377</u>	<u>438</u>	<u>473</u>
Prewar	25	25	25
Postwar	352	413	448
Foreign debt	<u>451</u>	<u>478</u>	<u>524</u>
Prewar	264	263	262
Postwar	187	215	262
Total	<u>828</u>	<u>916</u>	<u>997</u>

Although these increases in government debt are large (\$88 million during 1964 and an estimated \$81 million during 1965), the overall size of the debt is no cause for alarm. The total debt at the end of 1964 amounted to less than 25 percent of national income, a relatively low percentage compared with levels that governments in many industrial countries consider sound. The onerous aspect of the new borrowing is the rising proportion that is coming from abroad, 57 percent of the total in 1965 compared with 31 percent in 1964. This places an increasing burden on the government's foreign exchange reserves to make the payments of principal and interest.

### 3. Effects on the Economy of Government Fiscal Policies

Several symptoms of impending difficulty appeared in the Greek economy during 1964. Most serious was the rapid increase in the level of consumer spending and the drain on foreign exchange reserves. These trends arose largely as a result of the government's fiscal policies.

During 1964, consumer spending rose 13 percent while the total gross national product (GNP) of the economy increased by only 8.5 percent. The government's transfer of income from high-income groups, who save a relatively large share of their income, to low-income rural groups, who save little, probably was the primary cause of this unequal rate of increase. If the growth in consumer demand continues to outstrip the growth in output of the economy, the result is likely to be price inflation. Such an outcome would be intensified by the increases in the money supply caused by government

spending. The level of prices has not yet reflected the increases in consumer demand and the supply of money, but, if inflationary pressures continue to grow, stability will become increasingly difficult to maintain.

One reason that prices have not increased is that much of the new consumer spending has gone for imports. These have risen rapidly, at a time when exports and other items earning foreign exchange have been relatively stagnant. A serious depletion of the country's holdings of foreign exchange and foreign assets has resulted. Exacerbating this drain of reserves have been the large-scale private purchases of gold coin from the government, a speculative reaction that occurs during most political or economic crises in Greece. Such purchases probably amounted to between \$70 million and \$80 million during 1964, primarily because of the Cyprus crisis.

The severity of the drain on foreign reserves during 1964 does not show up in official statistics of foreign exchange holdings. The real decline was largely hidden as the result of drawings on reserves from surpluses in previous years that had been deposited abroad through commercial banks. Because these funds now have been nearly exhausted, the large drop in reserves likely to occur during 1965 will be reflected as a drop in official reserves and a drawdown of the central bank's special gold fund. At the beginning of 1965, official reserves were \$277 million. With a likely deficit in the balance of payments during 1965 of at least \$65 million, officially reported reserves can be expected to fall to below \$235 million by the end of the year and assets in special funds to fall by about \$30 million.

#### 4. Effects on the Economy of the Summer Political Crisis

During the interim between the Papandreou and Stephanopoulos governments this year, economic conditions in Greece deteriorated further. A decline in tax collections led the government to cut back its investment expenditures. At the same time, the Bank of Greece tightened bank credits because depositors were withdrawing their drachmas and converting them to gold sovereigns. Similarly, transactions on the Athens Stock Exchange virtually ground to a halt as investors preferred to put their money into gold sovereigns.

With regard to the balance of payments, the political crisis probably accelerated the drain on Greece's reserves of foreign exchange. While imports remained at a high level, emigrant remittances, tourist receipts, and the inflow of foreign capital declined.

Although the Greek economy is ailing, the situation is not beyond remedy. Factories, shops, and transportation continue to function smoothly in spite of the political turbulence, with economic repercussions being limited mainly to the financial sphere. Even there, the drop in foreign reserves, although serious, is not yet dangerous. The current level of reserves still provides a fairly sizable buffer against a balance-of-payments crisis.

If the Stephanopoulos government succeeds in laying the groundwork for political stability, the outlook for the next several months is for gradual economic improvement. Officials in the new government already have expressed willingness to reduce agricultural subsidy payments as well as to adopt other measures that will enlarge the surplus in the regular budget. This official shift toward economic conservatism is likely to renew confidence among businessmen and foreigners and thereby bring about an improvement in investment and the balance of payments. If the new policies cut too deeply into the incomes of the working class and farmers, however, agitation for a resumption of Papandreou's more liberal economic policies is certain to break out.

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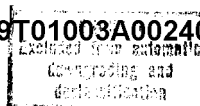
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