

THE EXPERIENCE OF GREECE FROM ITS PARTICIPATION IN THE EUROZONE

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ABSTRACT

This paper presents the experiences of Greece from its participation in the EuroZone. In the first part of the paper we analyze the theory of the single currency area. In the next part of the paper we argue that the euro area is not yet an "optimum currency area", as it is characterized by a generally limited flexibility of prices and wages as well as low labour mobility and in particular has no system of financial transfers from a federal budget. . In the third part the competitiveness of the Greek economy and its dependence on the current policy in the euro area are discussed. We suggest that the only solution is to increase labour productivity and the structural competitiveness of the Greek economy. The level of labour productivity in Greece is one of the lowest in the European Union. What is required for the success of the economic and monetary union is both the creation of a system of fiscal transfers for the transfer of resources to a member country which suffers - this alone - an asymmetric disorder and, on the other hand, an effective national policy aiming at structural changes in order to increase structural competitiveness.

INTRODUCTION

The monetary integration in its highest form requires the use of a single currency (Machlup 1979, p. 23). The cost that can result from a country's participation in a monetary union can be traced to the loss of its right to modify its exchange rate independently, the ratio between inflation and unemployment, and the loss of its ability to manage its regional economic policy as well as government revenue by issuing currency. The monetary integration brings many benefits. Among these is the elimination of exchange problems in the group of countries involved, in addition to increased influence on monetary issues and increase of monetary stability. The larger the area, the greater the benefits (Jovanovic 2002, pp. 292-302). The choice of the 16 countries of the European Union (EU), including Greece, to proceed to the creation of the EMU leads to the conclusion that these countries believed that the objectives of economic policy are achieved more easily when participating in a system of fixed exchange rates.

THE EUROZONE AND THE PROBLEMS OF ARCHITECTURE

Although the 13 years since the adoption of the Euro and the euro area as a monetary system are sufficient for a first assessment, they are insufficient for reaching final conclusions about its future. The idea of a single European currency was positive and very useful for the global economy because it challenged the monopoly of the U.S. dollar. The global storage of capital and foreign exchange was given an additional option, which would facilitate the liberalization of world trade. However, the architecture on which the single currency was based has great contradictions. In the theory of economics, a currency area can operate successfully only when certain conditions hold permanently - not occasionally.

The first condition is that the labour market should be under full mobility and flexibility. With regard to the criterion of wage flexibility in the labour market and labour mobility, the developments in the euro area are pessimistic. Despite the liberalization

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of border controls, job search from one country to another is very limited. This is mainly due to non-economic reasons, related to the difference of languages and lifestyle.

The second condition is that trade between the countries participating in the single currency area must represent the highest volume of total trade to GDP. Intra-European trade was strengthened within the single market but not as much as expected. There are large differences between the euro area countries' foreign trade indicators to GDP. For example, in Greece this ratio is 3.4% while in the Netherlands it reaches 51.8%. In terms of trade between the countries of the European Union, that stands at 10-20% of GDP. Specifically, in 1986 it stood at 14.3% while in 2007 it rose to only 16% of European GDP. Moreover, there is no longer the law of one price. Watching the markets of European countries, every single consumer can see that the law has very limited application. Excluding electronics products, whose prices converge to the average, most commodities prices show large variations from country to country. A classic example is car prices.

The third condition is that the economic and social structures of the countries that decide to establish a currency area should not show large discrepancies in their returns from the average, so as not to exhibit asymmetric shocks. In other words, the degree of economic integration between the countries of the region should be sufficiently satisfactory. In the case of this criterion/ requirement, i.e. the convergence of economic and social structures, the differences between the euro area countries are even more pronounced. Northern European countries manufacture products based on large capital reserves and skilled labour, while the countries of Mediterranean Europe produce mostly labour intensive products, based in many cases on unskilled labour.

This in turn creates imbalances in the balance of payments, we could say, of both groups of countries, because deficits and surpluses prove that the economies producing them are not in general balance. The former have social needs much larger than those they can satisfy endogenously, while the latter have much smaller needs than those they are able to finance. Thus, the most cursory but profitable solution that could be found came into effect. Deficit countries borrow from surplus countries uncontrollably for consumption purposes alone,

because if they had borrowed for production this would have been contrary to the interests of the latter. In other words, it would reduce the proceeds of the countries of northern Europe as well as employment. Reproduction of this phenomenon for more than ten years has led to the current debt crisis.

Finally, the fourth condition is a common or similar financial system, which will operate as a redistributive mechanism of transfers and taxation. If there are those four general requirements, the introduction of a single currency area with fixed exchange rates of the countries involved works to their advantage by increasing levels of performance. Otherwise, macroeconomic shocks will be caused, which may lead to variability and economic gaps within the region itself. In euro area countries with lower level of development, current disturbances affect key sectors of the economy and affect economic growth and employment more adversely than in the other countries of the euro area. The time elapsed since the introduction of the euro, reveals a field of contradictions and malfunctioning of the currency area, mainly due to the theoretical composition of its financial architecture. The theoretical basis adopts the seamless operation of automatic stabilizers as the mechanism that the monetarists believe can cope with disturbances on both the demand and supply. That would be correct if the above discrepancies disappeared between economic reality and the theory of optimum currency areas.³ Asymmetric disturbances and Euro area The euro area is not yet an "optimum currency area", as it is characterized by a generally limited flexibility of prices and wages as well as low labour mobility and in particular has no system of financial transfers from a federal budget (Garganas 2001, p. 8). With the loss of exchange rate policy as a means of adjusting economy to international pressure, the members of the euro area face asymmetric disturbances (Gikas 2004, pp. 183-87; Hyz 2012, pp. 99-115; Gikas 2012, pp. 135-146). What this means is that changes in the external economic environment affect differently the economies of individual Member States of the common currency area.

In the past, whenever the economy was hit by a crisis, an imbalance or external disturbance, the adjustment to international competition was achieved by means of exchange rate policy through devaluation or revaluation of the national currency. The rate of adaptation to the demands of international

competition is not a real solution but a simple shift in time. To put it differently, by resorting to changes in the exchange rate in order to offset the price difference resulting from lower productivity or higher inflation, we are not dealing with the problem but merely postponing it. The use of exchange rate policy may prove useful only in the short term, thus providing the time for the economy to adjust more smoothly to the demands of international competition.

In euro area countries with a lower level of development, the current disturbances hit important sectors of the economy and affect economic growth and employment more adversely than in the rest of the euro area. This uneven growth can cause considerable tension between Member States regarding the implementation of a common monetary policy, since there is no mechanism for fiscal transfers and the euro area is not yet an "optimum currency area".

Differences in living standards, particularly in the unemployment rate, will inevitably lead to political pressure to offset them through transfers from richer to poorer regions. At present, at the European level there is no financial mechanism to transfer funds to an individual member country being affected by a disorder. The EU budget is relatively small and its resources are mainly granted either as aids to agriculture or as structural aids, all of which represent less than 1.3% of EU GDP and only 2.5% of overall government spending for all EU countries (Garganas 2001, pp. 8-9). Fiscal policy in the euro area remains the exclusive competence of national authorities, unlike what happens in integrated federations such as the USA.

The adjustments between regions in the U.S.A. are facilitated by a system of implicit federal government transfers of real resources. The federal government spends a lot on lagging or inefficient States/regions and taxes them less, while in advanced States/regions it does the opposite. The EU, with its huge internal market, has not yet developed economic stabilizers to the U.S. scale in order to facilitate the adaptation of countries and regions within it. The EU has, however, developed structural funds. What the adaptation requires is not only the transfer of real resources, but also measures to increase the mobility of the factors from areas of low to areas of high productivity. In this respect, the EU has so far failed.

The need for direct financing of the EU budget by introducing a European tax (convergence

tax) would create the conditions for establishing a system of transfers among members of EMU. This currently seems unlikely with the existing political relations. It would also create serious disputes between member countries on how they would share between themselves the burden of these new contributions. Consequently, members of the euro area are obliged to face asymmetric disturbances with their own forces.

THE COMPETITIVENESS OF THE GREEK ECONOMY AND ITS DEPENDENCE ON THE CURRENT POLICY IN THE EURO AREA

The chronic fiscal imbalances which in the past three decades have led to the accumulation of very high public debt resulted, inter alia, from the lack of even a basic financial framework that would ensure the sustainability of public finances in Greece.

With regard to the recent crisis in Greece, the public dialogue which develops focuses primarily on the serious fiscal challenges the country is facing. However, there is also an additional, great challenge: the external imbalance of the economy, which takes the form of a large and persistent current account deficit. These two challenges are interrelated to the extent that the high fiscal deficit is a major cause of the chronically high deficit of the current account. At the same time, however, the magnitude and persistence of the external imbalance may also imply the existence of significant structural problems.

From 1960 until late 1990, the current account deficit in Greece was, according to national accounts data, between 0% and 5% of GDP. Notably, a surplus was recorded in some years. Although the data are not entirely comparable, from 2000 onwards the situation changed dramatically for the worse and the deficit peaked at 14% of GDP in 2008. This trend indicates weak competitiveness (Kazakos, 2010). In attempting to define the concept of national competitiveness, it can be argued that a national economy is competitive if it maximizes the living standards of its citizens without recourse to large external borrowing which will overturn the equilibrium of its balance of payments. In this case, determining competitiveness becomes technically complicated, since its measurement should include all those factors that determine the level of prosperity, such as growth rate, level of employment, income distribution, productivity, global market share, etc.

Similarly, competitiveness can be defined as "the ability to produce products and services which

meet the test of international markets while simultaneously maintaining high and sustainable levels of income." According to the definition adopted by the European Commission, a country or a region can be considered competitive if its productivity improves at a rate at least comparable to that of its trading partners, while at the same time maintaining external balance and achieving a high rate of new job creation.

Despite the fact that the improvement of the competitiveness of a country or region depends mainly on internal factors, consideration of the competitiveness of an economy is often compared to the progress of other countries. The success of an economy to adapt promptly, effectively and flexibly to the requirements of a constantly changing international economic environment can be analyzed only by using as a benchmark the achievements of other national economies or regions. The quest, therefore, for a better position in the arena of international competition is equivalent to a continuous process.

Usually, four structural factors are identified in the literature as closely associated with regional differences in the level of competitiveness (Hyz 2001, pp. 434-46): the structure of economic activity, the skills of the workforce, existing infrastructure, and the extent of innovative activity.

All of the above data form "structural competitiveness", as opposed to "competitive price", which refers to the amount of values by which domestic production competes with foreign products, either domestically or in foreign markets.

Following the adoption of the single European currency by Greece, inflation remained persistently higher than the average inflation in the euro area. The steady upward deviation of inflation in Greece than average inflation in the euro area decreased the international competitiveness of the domestic economy. In this case, the real exchange rate appreciated significantly and differences of this magnitude cumulatively impacted on competitiveness, with negative effects on real incomes and employment.

Competitiveness can be examined from various angles. One approach is the microeconomic, which focuses on the evolution of prices and costs in comparison with the quality of traded goods. Alternatively, based on a macroeconomic approach, external imbalances reflect imbalances that

characterize domestic households, businesses and the public sector. Finally, based on a developmental approach, the focus is on long-term potential output and total factor productivity.

It is often assumed that the deficits in current account within a monetary union do not matter, partly because the possibility of speculative attacks on national currencies is eliminated. Indeed, it is possible to argue that the deficits/surpluses recorded in individual countries or regions within a monetary union are due to the ordinary process of real convergence, in which capital flows out of the more advanced to the less developed countries or areas of the monetary union, which have higher efficiency and attract more capital investment. These capital flows are a reflection of similar imbalances in the current account. Along with the process of real convergence, these flows tend to decrease and investments that support the process of real convergence begin to bear fruit.

The experience of Greece, however, like other Southern European countries, has shown that this view is too optimistic. The deficits of the current account were usually accompanied in these countries by an accumulation of foreign debt. In some cases, there is the possibility of funding continuous and large deficits with flows of funds that do not create debt, e.g. from foreign direct investments (in Greece, the inflow of foreign direct investment has averaged less than 1% of GDP). The debts, however, cannot continue to accumulate indefinitely, since they have to be serviced along the way and to be repaid at maturity. Smooth external debt servicing is possible if and when capital inflows are channeled into productive investments, whose returns are sufficient to cover the cost of borrowing. Servicing will not be possible, however, if the accumulated debt is channeled into consumption. Because the existence of current account deficit reflects the fact that the country spends more than it produces, the normal repayment capacity of external debt presupposes that there will be a period during which the total cost will be lower than the total output of the economy.

This approach of the current account deficit reveals a compelling truth: the external deficits cannot be kept large forever, if they reflect an exaggerated total domestic consumption. The high and sustained deficits create foreign debt, which can develop an unstable dynamic – that is, increasing as a percentage of GDP or, in other words, as a percentage of the

country's capacity. It is this dynamic, coupled with the dynamics of public debt (whether domestic or foreign), that definitively refutes the view that speculative attacks can be eliminated by participation in a monetary union. Although speculative attacks on national currencies cease to exist by default, because in a monetary union there are no individual national currencies, speculative attacks against countries with high debt are still possible and can be triggered by unsustainable deficits in the current account, i.e. deficits that add unstable dynamics to external debt. In countries of a monetary union, such speculative attacks occur through the credit risk, in the form of widening credit spreads in interest rates in bond markets. A typical case is the recent experience of Greece. It is not only the budget deficit that has contributed to the current funding problem the country is facing, but also the current account deficit, which reflects the excess of consumption in relation to income, both in the private and public sector. Moreover, the current account deficit led to an increase in external debt as a percentage of GDP from just over 40% in 2001 to about 165% in 2011 (Bank of Greece, 2011). Additionally, during this period, interest payments on external debt are increasing and today represent more than 5% of GDP.

This situation is not sustainable. Policies must be implemented to improve the competitiveness of the Greek economy and, by extension, to improve the current account deficit to sustainable levels.

For a detailed examination of the deficits of the current account or the problem of competitiveness (Gikas, 2004, pp. 183-87) it is possible to follow alternative approaches. At the micro level, one can distinguish between competitive price/cost and structural competitiveness. The first relates to factors such as changes in labour costs per unit and profit margins compared to competing countries, in juxtaposition with developments in the nominal exchange rate. Indicators of this kind have recorded for Greece, since its accession to the euro area, a cumulative loss of price/cost competitiveness in the range of 20-25%. The social partners, apparently either do not consider the factor "competitiveness" in the process of wage bargaining or have not adapted to the data of a monetary union, in the framework of which there is no longer the possibility to use the nominal exchange rate as a tool to offset the deficit of competitiveness.

One feature of international trade

transactions today is the importance of intra-industry trade, which stems from the high product differentiation. The consequence of this differentiation is that demand is not determined only by price but also by other factors such as product quality, prestige of the brand name, etc. Given this background, the issue of competitiveness is also connected with parameters such as the particular characteristics of the products being produced. This raises the central question of whether production is oriented towards sectors with high added value.

Studies investigating the determinants of Greek exports and imports confirm that the comparative performance of local products and services to their respective foreign is linked to competitiveness not only in prices but also in relation to other parameters (Hyz, 2001, pp. 434-46) which are extremely important, especially for two key export sectors of the Greek economy: tourism and shipping.

The sustainability of current account balance can also be seen in macroeconomic terms, according to which external imbalances reflect internal imbalances of the public and/or the private sector. As an accounting identity, the current account deficit coincides with the sum of the deficits of the public and private sector (the amount by which the investments of each sector exceed the savings). After its integration in the euro area, the Greek economy has been characterized by growing fiscal deficits. At the same time, the private sector (households, to be exact) has also had deficits, mainly due to a significant decrease in the propensity to save, marked in this sector already in the 1990's, before joining the euro area. The mounting deficits in both the private and public sector cannot be attributed to a permanent increase in the propensity to invest. This fact is essential. In contrast to consumption spending financed with borrowed funds, investments undertaken are expected to result in future returns, from which a part may be available to repay the original loan. Therefore, when long-term foreign borrowing finances consumer spending, a future period will inevitably follow during which the consumption will need to be below the income, so as to enable the servicing of foreign debt repayments and interest.

According to the macroeconomic approach, the deficit of current account can be attributed to the fact that the development was mainly driven by demand, so the total domestic demand for goods and

services exceeded for many years the potential proceeds of the Greek economy. Both the public and the private sector contributed to the large external deficits and foreign debt accumulation. Therefore, both sectors are now required to adapt their structures and behaviour in ways that will make it possible to reverse the momentum of the country's total external debt.

Finally, another approach to the current account balance is based on the analysis of the potential output and sources or factors that determine the long-term rate of economic growth. The concept of competitiveness has been criticized for showing trade as the scene of conflicts between countries – something that contrasts with the prevailing economic theory, which concludes that international trade benefits all countries involved in it. The improvement of alternative and macroeconomic performance of a country by strengthening competitiveness ultimately goes back to the issue of improving total factor productivity, i.e. the productivity of both labour and capital. The stable and sustainable growth requires primarily a boost of the potential growth rate, which for small economies is only possible with a central channeling of production mainly to tradable, instead of non-tradable, goods.

From the above approaches to competitiveness some policy proposals could arise. The macroeconomic approach, as mentioned above, leads to clear conclusions. The policies that improve the fiscal position contribute to a deficit of current account. At the same time, policies that encourage private sector savings on the one hand, and tame consumption by borrowing on the other, contribute to bridging the investment/savings gap of the private sector. Such policies attempt to deal with the current account deficit primarily from the demand side and are aimed at realigning the growth rate of total demand in the economy with the growth rates of its productive capacities.

On the other hand, the microeconomic approach emphasizes the need to improve the performance of the Greek economy from the supply side and to promote the openness and flexibility to cope with external shocks which may occur in the monetary union. For this purpose, reforms are needed in the labour market (including education and vocational training) and in product markets, in addition to upgrading the quality of institutions.

Greater flexibility facilitates adjustment in a

monetary union, in which by definition improvement of the price/cost competitiveness cannot come from a unilateral devaluation of the currency, but only by improving the relevant cost and the relevant profit margins in comparison with the rest of the union.

CONCLUSIONS

The participation of a country in a single currency area does not allow the use of national instruments of monetary and exchange rate policy. While having limited choices, it is also forced to adopt policies that serve the more developed countries, in the expectation that it will manage to reach the same level. In the case of Greece, this issue becomes even more important if we consider that the Greek economy is characterized by low competitiveness in comparison to more economically developed countries of the EU. The steady upward deviation of inflation in Greece in relation to average inflation in the euro area decreased the international competitiveness of the domestic economy. As a result, the real exchange rate appreciated significantly and differences of this magnitude had a cumulative impact on competitiveness, as well as negative effects on real incomes and employment. There are four ways to adapt to the pressures of international competition: the change in the exchange rate, the reduction of production costs, declining margins and, finally, increasing labour productivity and improving the structural competitiveness of the economy.

With the adoption of the euro, Greece no longer has the ability to use the exchange rate policy as a way of adapting to international competition. Therefore, what remains as a means of short-term adjustment is either the reduction of production costs or reduction in profit margins. The long-term adjustment means would be on the one hand to improve structural competitiveness, and on the other hand, to increase labour productivity at rates above the European average.

As for the short-term adjustment, it is attempted to achieve that at the expense of labour, i.e. by reducing the share of labour in the product; in other words, income redistribution at the expense of labour. While the adjustment of a national economy under national currency is made with exchange and fiscal policy as a tool, participation in the euro area has transferred all the pressure of international competition on labour reward and much less on firms' profit margins.

However, neither the continuous transfer of the burden of adjustment to the world of labour nor the continuing decline in profit margins are long-term solutions, because the first seriously aggravates the living standards of labourers while the latter undermines the ability of firms to invest. For this reason, the two aforementioned adjustment policies are short-term or even medium-term arrangements.

The only solution is to increase labour productivity and the structural competitiveness of the Greek economy. The level of labour productivity in Greece is one of the lowest in the European Union. What is required for the success of the economic and monetary union is both the creation of a system of fiscal transfers for the transfer of resources to a member country which suffers - this alone - an asymmetric disorder and, on the other hand, an effective national policy aiming at structural changes in order to increase structural competitiveness.

The European Central Bank is the entity that decides ultimately upon the kind of policies of the Member States. However, the policies pursued by the European Central Bank are tailored to the economies of some countries, especially Germany and the Benelux countries. Its main objective is price stability and to avoid inflation in every possible way. It is not concerned about any developmental issues or redistribution of income or unemployment. At the same time it enjoys complete independence in its movements. The phenomenon of asymmetric disturbances, which is on the rise currently in the euro area, cannot be addressed by the European Central Bank; both because it is not within its statutory jurisdictions and also because it is outside its policy orientations. For example, a gap has opened between the South European periphery and the European North. These two economic realities, quite logically, require different policies of economic management.

Finally, the conclusion is that the Treaty of Maastricht, which supported the foundation of its criteria on monetarism, cannot provide the tools to address the current crisis in the euro area. Its continued application can only result in widening the gaps and asymmetric disturbances between the two groups of countries, and certainly threatens the very existence of the single currency. If European leaders wanted to keep the single currency alive, they should move in a different way. The crisis in the South ought to be an opportunity for the reconstruction and reform of the euro area itself for the sake of the living

standards of European citizens and the strength of their economies. This means that the Maastricht criteria should be amended so as to become more flexible, while at the same time changing the role of the Central European Bank. Its statutory objectives should include the issues of growth, employment and productive convergence of euro area economies.

As events unfold, the cost of a country's participation in the single currency area tends to be larger than the benefit it provides.

It follows naturally that the euro area is not an optimum currency area; precisely the opposite. In order to become optimum in the classical sense, it should proceed with internal reforms that will ensure not only price stability but also convergence of the level of real economy among the member countries, so that they can stop producing asymmetric disturbances, namely exorbitant deficits and debts on the one hand, and excessive surpluses on the other.

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