

A NEW ECONOMIC POLICY

Creating a favorable environment for investment

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There has been a lot of debate in the last years concerning the two most important challenges Europe is facing: globalization and demographic ageing. Globalization is an exogenous force. It is related to the opening up to trade of new, emerging economies and the advances in transportation and communication technologies. It has unleashed its competitive forces since the 1990s and is proceeding rapidly, creating gains for those who can benefit but, also, causing difficulties where competitive advantages have not been identified and exploited. Demographic tension, on the other hand, is endogenous. It is the outcome of low birth rates for a number of years which reversed the demographic pyramid and increased dramatically the dependency ratio (number of people aged 65+/number of working age (15-64) population)¹. In addition, progress achieved in medicine and life quality, have increased life expectancy exacerbating the dependency ratio issue.

The European Union foresaw the challenges early on. In 2000 action was undertaken which led to the adoption of the **Lisbon Strategy**. Europe did not remain indifferent but recognized to the challenge and introduced a number of reforms which would allow it to benefit from global changes and relieve internal strain. The target was to make Europe **the most competitive and knowledge-driven economy** worldwide, emphasizing the need for social and environmental protection. Three policy areas were distinguished related to “macroeconomic”, “microeconomic” and “employment” issues. Broad policy guidelines were then recommended. The basic idea was to use knowledge and innovation, encourage entrepreneurship, improve education and increase skills in order to enhance Europe’s productive potential, while maintaining European social values. Hence, improving the business environment was a prerequisite. In a nutshell, the vision was for Europe to focus on its comparative advantage: **knowledge and quality; entrepreneurship and innovation; environmental awareness and social cohesion**.

Greece, being part of the EU, faces similar challenges. Although it has experienced higher growth than its partners, which led to gradual convergence², and benefited from the stability of entering the eurozone in 2001, by 2004 its public finances remained unsettled and its microeconomic environment needed urgent reforms. Education, training, life-long learning and active ageing were also issues which required a new approach. In 2004 GDP per capita

was 81% of EU25 and although growth remained high at 4.7%, fiscal deficit and debt had reached 7.8% and 108.5% of GDP respectively. The excessive public debt led to interest payments which amounted to almost 5% of GDP, while unemployment was 10.5%. Greece was losing its competitiveness fast as was shown in all rankings compiled by the IMD, the World Bank, the WEF. Moreover, exports were declining and foreign direct investment was limited.

The new government of March 2004 was elected on the grounds that it would promote long-needed and awaited reforms. A new economic policy, in full agreement with the Lisbon Strategy, was introduced. Growth was to be mostly based on healthy private initiative, while fiscal discipline had to be restored. Modernization of education and training had to be pursued and life-long-learning introduced. The state was to ensure social cohesion and environmental protection. The introduction of a transparent and stable regulatory framework and the improvement of public services were also priorities. Abundant European Support Framework funds had to be appropriately invested³. The new policy figured prominently in the National Reform Program 2005-08 submitted to the European Commission.

Fiscal consolidation was attempted mainly through the reduction of non-productive public expenditures and an increase in public revenues through confining tax evasion and increasing the rate of VAT up to 19%, the rate of tax pre-payment for enterprises and banks

and the excise tax on fuel and cigarettes. On the expenditure side, efforts were enhanced by new legislation regarding fiscal audits and controls, including the establishment of a General Directorate for fiscal audits along with internal auditing agencies within Ministries, local authorities and public entities in general. To this effect the adoption of sound corporate governance rules for the enterprises of the broader public sector was also initiated.

Micro-economic reforms were necessary to build an investment-friendly environment. A series of measures were introduced starting with a gradual reduction of corporate tax rates from 35% to 25% until 2007⁴. A generous investment incentives package, offered by a new investment law, provided grants of up to 55% of the investment cost, strongly supporting small and medium enterprises, new sectors and new activities. Other measures that contribute to the improvement of the business environment included an easier, cheaper and faster start-up procedure for new manufacturing firms (to be extended to commercial firms until mid-2007); an expansion of existing organized industrial zones as well as the creation of new ones; the preparation of national spatial plans for specific land use purposes such as tourism, renewable energy resources and industry.

A new framework for Public Private Partnerships (PPPs) was successfully introduced, creating a stable and transparent legal basis for such agreements. PPPs provide an ideal alternative to public spend-

ing for certain infrastructure projects and at the same time provide profitable opportunities for the private sector. A special secretariat for PPPs was established which has already approved projects reaching €800m, while it is currently evaluating projects of €1.4bn in the fields of health, education, sports and justice.

To increase competition and, thereby, productive efficiency, an extensive privatization program has been initiated. In addition to the banking sector, where more competition was required in order to reduce concentration and improve services, the gradual opening of network industries, such as telecommunications and energy provides further opportunities for domestic and foreign investors. Especially in energy, the introduction of a new law defining the liberalization process and providing a transparent framework for the participation of the private sector has attracted vivid interest by domestic as well as significant foreign players.

Improvement of the regulation of the stock market was also effected in order to comply with European legislation and ensure reliability and transparency of transactions. Moreover, special attention was given to reduce the administrative burden and improve the quality of draft legislation through an impact assessment process with a view to promote the competitiveness of the Greek economy. Greece agreed with other EU members to reduce the administrative burden by 25% within the next five years. With respect to cutting red tape and speeding up bureaucratic

procedures the introduction of e-government has been decisive. To further support e-communications and promote the use of broadband for business and households, a new digital strategy was implemented. Subsequently, broadband penetration increased to 4.5% in 2006 from 0.1% in 2004, prices were slashed and the number of ADSL subscribers has been increasing by more than 30,000 per month.

Furthermore, a national strategy for R&D is being drafted to encourage innovation and research in both the private and public sectors. According to the National Reform Program, Greece has set a target for R&D expenditures at 1.5% of GDP by 2010 and a series of measures, such as tax cuts and grants, are being implemented to this effect. Fostering clusters and innovation poles for high technology is also pursued with the participation of major multinational companies. Athens and Salonica have already seen the first such establishments and more are planned in other cities of Greece.

To further develop the R&D potential, a major educational reform introducing changes in Greek Universities and promoting research is currently under discussion in Parliament. The reform is expected to greatly improve Greek Universities and the quality of knowledge produced and transmitted. Greece has one of the highest educational attainment rates in the EU (84.1% of its young people have completed upper secondary education compared to 77.4% in EU27). It also has a vast supply of graduates from Greek and foreign universities,

with high technical competences, foreign language skills and international experience. The target of the educational reform is to further improve the quality of future graduates but also to attract prospective students from the wider region of South-Eastern Europe.

The smooth operation of the labour market is imperative for creating a competitive business environment, since labour relations greatly affect investment decisions. To this extent, Greece is currently implementing a series of measures to increase employment, improve the quality and productivity of labour and promote social cohesion. The easing of overtime restrictions and the extension of opening hours for shops also serve these purposes. More measures on the supply side place particular weight on promoting part-time and other flexible forms of employment, and especially supporting women's participation in the labour market, while maintaining job security.

To enhance the openness of the economy special attention has been given to the promotion of exports. The Hellenic Foreign Trade Board (HEPO) has been reorganized, focusing on vigorous marketing of Greek firms and their products. Active participation in international fairs and exhibitions has been encouraged. Successful business and trade missions took place in mature markets as well as in emerging ones, such as China and India. In 2005 and 2006, 10 and 37 business missions respectively travelled abroad and contacted foreign markets through thousands of carefully organized 'b2b'

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meetings. HEPO focuses on three groups of products and promotes them separately: a group on food and drink and Greek cuisine (mostly agricultural products); a group on Greek lifestyle based upon clothing, textiles, accessories, leather and furs; and a group on building/construction materials. The three groups were promoted in different markets and with different missions. The results were positive: in 2005 and 2006 exports increased by 13.7% and 18.2% respectively. In 2006 the contribution of exports to growth exceeded 25%.

Greece is becoming the centre of a new emerging region in the South East of Europe, a region where incomes are increasing fast and the number of potential consumers is rising. Greece is in an ideal position, being the oldest EU member and a eurozone member as well, to support the European orientation of the region; to strengthen the long-established links of partnership; to provide services in finance, transport, logistics, trade, education and tourism. Thus, Greece may be envisioned as an investment platform for a broad market of 140 m. people. Serving such a market is a strong pull factor for inward Foreign Direct Investment (FDI) but also a push factor for outward FDI by domestic firms. Both types of investment have been steadily increasing, providing clear signs of

an open and dynamic economy playing an important role in its broader 'neighborhood'. As shown in Table 1 the flows of inward and outward investment in 2006 reached their highest values of €3.3bn (\$4.3bn) and €4.3bn (\$5.6bn) respectively. The majority of such investments are in the financial sector, while the sectors of industry, tourism, insurance, energy and telecommunications follow.

The reforms produced a positive outcome. The fiscal consolidation process followed can be considered a European success story taking into account the fact that the deficit was reduced by more than five percentage points to 2.6% of GDP in 2006, while growth remained vibrant at 4.2%. Subsequently, the general government debt was reduced to 104.3% and is expected to reach 100% by 2007. Unemployment followed a persistent downward trend reaching 8.3% in the third quarter of 2006, while employment has been steadily increasing. One important characteristic is that women's participation in employment increased at almost double the speed of men's, thereby reducing the observed gender gap. A record high of 4.5 million people have been in employment in the third quarter of 2006 marking an increase of 250,000 since the first quarter of 2004. Only 1/5 of them have been hired by the public sector⁵.

Table 1 Greece: Inward and outward FDI (in USD million)

	1998	1999	2000	2001	2002	2003	2004	2005	2006
Inward FDI	72.1	561.5	1,108.1	1,589.4	50.3	1,276.4	2,102.6	606.1	5,558.0
Outward FDI	-275.6	552.1	2,136.5	616.1	655.3	412.6	1,029.7	1,450.0	4,318.1

Source: OECD, Bank of Greece

OPPORTUNITY GREECE

Growth in 2006 was mainly fuelled by increases in investment (increase 9.9%, contribution to growth 2.35 pp) and exports (increase 18.2%, contribution to growth 1.04 pp). Special reference has to be made to the success of the new investment law: 4,406 investment projects have been submitted in two years; 2,419 have already been approved worth €4.5bn and receiving grants of up to €2bn. These projects are mostly in tourism and manufacturing and are expected to create more than 10,000 new jobs⁶. The Greek economy is converging rapidly with the EU and competitiveness has registered significant improvement. GDP per capita was 84.9% of EU25 in 2006. According to the latest IMD and World Bank reports, Greece's competitiveness improved its ranking by eight and two places respectively.

In 2005, the renewed Lisbon Strategy advanced a broad platform for reforms. For Greece, such reforms had already been on the political agenda since the elections of March 2004. A new economic policy was introduced in order to tap the potential of the economy and create a favourable environment for investment. Although major challenges are still to be faced, many new opportunities have been created for local and foreign investors. Greece is becoming an

attractive business hub in South Eastern Europe with an increasing role in its "regional" economy.

¹ In 1995 the (old age) dependency ratio in EU25 was 22%. In 2005 it was 25%, while it is forecasted to reach 36% in 2025 and 53% in 2050.

² GDP per capita increased from 71% of EU25 in 1997 to 85% in 2006.

³ The 3rd European Support Framework Program is currently running (until 2008), while its continuation (the National Strategic Reference Framework) started in 2007 and is expected to run until 2013. The funds involved exceed €23bn and €20bn respectively.

⁴ Personal income tax has also been reduced by increasing the threshold tax-free income since 2005, while introducing lower tax rates since 2007.

⁵ Labour productivity (GDP per person employed) increased from 92.1% of EU25 in 2001 to 101.4% in 2005 and (an estimated) 102.5% in 2006.

⁶ According to the Global Entrepreneurship Monitor 2006 report, Greece has improved its ranking to 19th out of 42 countries and 4th out of 21 European countries being evaluated in new entrepreneurship, i.e. percentage of working age population starting a new business or pursuing a new business plan for more than three but less than 42 months (new entrepreneurs).

USEFUL LINKS

Ministry of Economy and Finance
www.mnec.gr

Hellenic Center for Investment
www.elke.gr