M E M O R A N D U M

of the Prime Minister

Mr. AL.N.DIOMEDE

ON PENDING ECONOMIC PROBLEMS OF GREECE

handed to

AMBASSADOR HENRY F.GRADY

July 20, 1949

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The main feature of the peculiar economy of Greece, is a general disequilibrium, following the disasters that occurred since 1940. This disequilibrium manifests itself in all branches of economic activity, aggravating the traditional organic weakness of the Greek economy. Hence, there is nothing in the economic life of the country that develops under normal adaptation and evolution conditions. All the manifestations of our economic life have necessarily assumed an artificial character. The unhealthy phenomena of our economy and the resulting problems have not got their like in any other European country.

For this reason, if the precious U.S. assistance is to give the results, that are expected from it, it must not neglect the peculiar nature of the Greek economic problem.

Greece subsists to-day largely thanks to U.S. aid. This covers our deficit which represents app.2/3 of our needs. A reduction of the deficit does not seem easy. It is, however, possible to restore some health into our economy if the measures of internal economic order hereinbelow set forth in connection with the monetary, foreign exchange and credit situation of the country are seriously taken into consideration.

The public finances are not touched here as they will be dealt with separately.

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Analysis of the situation.

Our external accounts have been adverse for a number of years. The currency has lost every vestige of stability. For psychological as well as objective reasons its purchasing power has been going down continuously. As it was to be expected, the cost of living index has been showing a parallel rise. The phenomenon, however, of the rise in the cost of living index, has another objective cause, namely the inadequacy and irregular importation of supplies. This is one of the real factors making for instability in the purchasing power of the currency and, naturally, price rises.

The instability of the currency and the deep credit crisis, have combined to dislocate almost completely the banking system of the country. The credit system with which the Greek economy functioned for more than a hundred years has been disrupted.

In fact, it could be said that the money market which was formerly functioning in Greece meeting the internal economic requirements of the country, does not exist any more.

Thus savings in the form of Bank deposits are negligible, while such deposits as there exist are largely compulsory and not voluntary.

Almost the only source from which the economy can draw funds, is the issuing mechanism. This results in its extremely abnormal functioning because every production requirement in any sector financed in this way causes an increase by an equal amount in monetary circulation and further exerts a stronger or weaker influence on prices.

A policy, however, of maintaining monetary circulation at as low a level as possible, cannot provide a solution to the problem. This compresses the economy because it curtails certain essential economic functions. Goods transport is deficient, the requirements of the small producer are not met, the provinces are lacking funds, and the rate of interest rises to an extremely high level while the punitive measures taken to reduce the trouble are completely ineffective.

Production costs and prices remain high, the instability becomes general and every kind of economic activity is slackening.

The most menacing conclusion, however, is that not only the so-called monopolistic center, but the entire chain of producers big and small, are speculating on the depreciation of the currency. They borrow in order to pile up stocks while they sell the existing ones at a very slow rate in the hope of a price rise. An investigation, if it were possible, would not unlikely prove that small traders' stocks taken as a whole are not smaller than the stocks of the big merchants and industrialists.

The result of this unhealthy situation is that for years now, the people have turned to gold. For years now gold has become the real measure of value and the instrument used in a multitude of transactions, not only big ones but also small transactions of every day life.

The result of this general disequilibrium and the efforts to maintain prices at as low a level as possible through artificial means, are the arbitrary rates of exchange. These rates, however, which are enforced from above are in fact ignored in the functioning of the economy. The price index of foodstuffs is 75% higher than the official rate of exchange thus exceeding even the unofficial rate of the dollar. For this reason, in spite of every arbitrary effort to make people ignore it, the public is completely indifferent to official exchange rates and turns to the freely determined rate which is the one that influences prices.

The artificial exchange rates squeeze particularly the receipts side of our balance of external payments. Before the war our exports covered 75% of imports while nowadays they cover only 1/3 (out of the app. $350 mil. worth of imports programmed for 1949-50, only $95 mil. are covered by exports).

Nonetheless even these reduced exports would be impossible if they were not subsidised from the Budget. But while the entire volume of exports is in some way subsidised, the only type of import which is forced to ignore the real rate of exchange is the capital coming from abroad . The foreign excange content of such transactions is converted at the rate of 10,000 drs. to the dollar as against the real rate which stands at 14-15 thousand. In other words the importer of capital is forced to lose in order not to be prosecuted. On the other hand, if he is not in immediate need of funds he does not bring his capital into the country. The result of this abnormal phenomenon is that while before the war we realised $60-75 million from invisibles, nowadays it is even doubtful whether we reach $25 million.

The policy that is being pursued certainly deprives us of our own precious capital resources and continually reduces the credit elements of our balance of payments at the expense of the country's recovery. Finally, the artificial rate of exchange introduces a troublesome factor into the entire economy of the country. The U.S. Secretary of the Treasury has himself openly declared in Brussels that artificial exchange rates cannot be maintained and are harmful (Le Monde July, 13,).

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Measures for the restoration of health.

Since we have been driven away from the rate that at one time corresponded to reality, it may be asked whether we should not follow the rate that is now prevailing in the free market. This may have some undesirable results. If the now prevailing actual exchange rate were generally adopted we would have to face a rise in the cost of living because the essential commodities coming from abroad would have to be paid for at a higher price. Consequently, we should avoid as far as possible to disturb prices, at any rate as regards foodstuffs and some other essential commodities. Other countries too (England) are doing something similar. For the rest, it is to our interest to recognise the real situation and accept its rulings.

If we accept the exchange rate determined by the free market as far as other commodities are concerned, it may be asked whether we would not have to face a price rise as a result. I do not think that this rise will be substantial because the prices of the majority of goods are already being calculated on the basis of the higher exchange rate, either because they have been imported through private barter or because they are made to follow the prices of this category of goods or because the entire economy has recognised and accepted it as the economic reality. An attempt to strangle it would lead to black-marketeering, hiding of stocks, clandestine speculation and all the disastrous consequences of illegal transactions.

I do not deem advisable for the time being to proceed to a general re-adjustment of exchange rates by legislation.

I am of the opinion that it would be more profitable if the Bank of Greece purchased foreign exchange according to its own judgement, taking into consideration the automatically determined rate, which would not naturally be permanently fixed but elastic and flexible, something, by the way, that is being done in all continental European countries except England.

The freely determined rate is not artificial as some people maintain on the grounds that as long as capital cannot be freely exported the area of free movement is restricted. In all Continental countries that were completely isolated in this respect, apart from the official rate there appeared in places free market rates on which the economy could count without (as with us) this being considered illegal and punishable by law.

It is certain that there is a tendency towards an inflow of Greek capital from abroad, but naturally not yet in the form of investment. It is absolutely logical to expect that Greek subjects who possess capital abroad or have smuggled it out, will bring it back into the country as long as the exchange rate is profitable to them. It is incomprehensible that we should place artificial barriers to imports of our own capital.

This capital by coming into the country will reduce the cost of living. If the rate of interest is at present high, it is not so much because of lack of security but rather because of a shortage of capital. If we attract our own capital to our country, an even modest rate of inflow ($ 1-1.5 million per month) would throw into the money market, particularly in the provinces, a sum of 15-20 billion drs. per month. Would not this benefit Greek production?

In order to strengthen our economy we must first erect as many ramparts as possible against instability. It is organically necessary to attempt to revive our banking mechanism without which Greece cannot lead a normal economic life. With the Bank of Issue alone, the Greek economy is condemned to inflation or famine. The credit system and the currency need support. It is advisable therefore that the value of bank-deposits be calculated on the basis of an accounting currency unit. The Banks will both accept deposits and give loans on this basis. The same procedure should be followed as regards Bank of Greece advances. By this is meant that the dollar equivalent of the drachmae deposited will be written down side by side with the drachmae figure. The drachmae will gain in strength in the eyes of the public and acquire a certain and stable value. This will dissuade entrepreneurs from speculating on the fall of the drachma's value and will reduce to a certain extent the demand for gold. Such a solution would create a tendency towards deposits in drachmae and thus a stable element would be introduced into the movement of transactions.

The attempt to force the liquidation of existing stocks through credit restriction fails often, because the industrialists or merchants prefer to retain their stocks in spite of every effort to the contrary, as they represent real values to them. We will succeed in this respect only if lending is carried out from now on in drachmae that follow the value of the dollar. There will then be no reason for unproductive lending as there will be no profit in it.

It is to our interest to increase imports of essential commodities particularly from private exchange resources over and above the volume of programmed imports. Thus we will use profitably Greek funds which remain idle abroad not daring to return to the country and at the same time we will be able to increase the supply of those goods, the shortage or irregular imports of which push prices upwards.

The rationing of certain imported commodities is indicated. It would be a great error however, to attempt it, if a) the certain distribution of essential commodities in quantities sufficient for the maintenance of the individual and b) regular, continuous and unhindered imports of the goods necessary for this purpose, are not at the same time ensured. In the absence of sufficient pre-existing stocks on which the distributing agency could draw, the system would not function successfully to the detriment of society as a whole. This would lead to the hiding of goods, black marketeering and all the pernicious consequences that derive from it.

It is a mistake to think that the Greek economy can only be cured through a reduction of consumption and that consequently we must restrict the supply of capital. This would be right only if credit were granted each time through additional bank-note issues, but not if it came from funds that are active within the limits of existing circulation. This would happen if Greek capital started coming from abroad and deposits were secured through the use of the accounting currency unit.

To insist on the opposite view would be to misunderstand Greek realities and the peculiarities of Greek economic life.

The restoration of health to the Greek economy with the co-operation of the country's own capital resources which are now inactive, together with a greater freedom of movement within the economy, will prove that there exist active forces which are now in abeyance but which are of great importance to economic recovery.

Such activity would certainly contribute towards making the assistance of the U.S.A. more effective. Its functioning would become smoother creating at the same time the pre-requisites of the now planned new structure of our economy which, we hope, will ensure a brighter future for our country.

AL. N. DIOMEDE

Athens, July 20th, 1949

Comparative development of official and free-market exchange rates.

Year-Month	POUND STERLING Basic rate exchange certificate rate.	Free Market Rate	DOLLAR Basix rate exchange certificate rate.	Free Market Rate
1947 December	25,796	28.330	8.567	11.400
1948 January	26.904	27.600	9.984	11.440
July	30.003	38.833	10.019	14.121
August	30.205	39.487	10.021	14.000
September	32.128	37.395	10.042	13.404
October	32.157	36.033	10.046	13.103
November	32.175	36.333	10.050	13.212
December	32.144	38.814	10.020	14.049
1949 January	32.157	38.650	9.900	14.150
March	32.151	41.650	10.027	14.550
May	32.294	42.250	10.067	14.300

DRACHMAE - DOLLAR

PURCHASING POWER RELATIONSHIP

1938		$ 1	112,62
1947	Sept.	5000	11346,59
	Oct.	7995	11695,58
1948	March	8995	15205,95
	Nov.	10030	15476,24
1949	March	10015	17748,91 (+)

(+) Provisional data

Development of monetary circulation,
the price of the gold sovereign
and the cost of living index.

		Monetary circulation (In million drs.)		Price of the gold sovereign (In drachmae)	Bank of Greece Cost of living index
1946	Jan.	131.471		148.346	158,2
	Feb.	218.644		141.708	136,6
	March	278.742		135.875	139,5
	June	411.944		136.982	144,6
	July	444.129		134.585	144,2
				gold sovereign sales suspended	
	Sept.	511.669		135.587	144,4
	Dec.	537.463		136.212	145,5
1947	March	559.370		134.980	161
	June	690.452		135.217 (1)	168,3
	Sept.	763.616		147.444	175,5
	Dec.	973.609		192.708	216,24
1948	Jan.	893.312		221.140 (2)	229,1
				gold sovereign sales resumed	
	March	888.159		231.128	224,6
	June	1.011.805		231.286	243,4
	Sept	1.018.168		226.592	251,3
	Dec.	1.052.080		226.488	265,6
1949	Jan.	1.130.406	(3)	228.958	280,1
	Feb.	1.135.975	"	228.763	283,4
	March	1.125.122	"	228.312	290,4
	April	1.250.188		229.021	285
	May	1.219.278		229.217	285,4
	June			228.591	

(1) Gold sovereign sales suspended
(2) " " " resumed
(3) Provisional

DEVELOPMENT OF BANK-DEPOSITS

In millions of 1938 Drachmae

31.12.38	23.520
31.12.47	1.771
31.12.48	2.630
31. 3.49	3.222
30. 4.49	3.354
31. 5.49	3.598

Bank Advances

BANK	December 1939 In million drachmae	December 1939 Expressed in Dec.1948 drachmae	December 1948 In million drachmae	Percentage ratio of present day to 1939 advances expressed in present day drachmae
Commercial Banks	16.877	4.482.700	977.941	22%
Agricultural Bank	3.961	1.052.081	808.181	77%
Total	20.838	5.534.781	1.786.122	
Bank of Greece	380	100.931	211.672	209%
	21.218	5.635.712	1.997.794	

The figures referring to December 1948 can be broken down as follows:

Credit Requirements Covered

	Industry and Commerce	Agriculture	Total	
a) From the resources of Commercial Banks	595.234		595.234	30%
b) Through the increase in bank-note circulation by the Bank of Issue	594.379	808.181	1.402.560	70%
Total	1.189.613	808.181	1.997.794	
Percentages	60%	40%	100%	100%

	Monetary circulation (mill. drs.)	Bank-deposits All kinds (mill. drs.)	Bank-deposits expressed in terms of 1938 drachmae ++ 1938 = 100	Percentage ratio of bank-deposits to monetary circulation
31 Dec. 1938	7.238	22.887	22.887	316,2
31 " 1939	9.452,8	22.486	22.713	237,8
31 May 1949	1.219.278	910.218 +	3.189	74,6

Notes:

(+) 44,3% approx. of this figure, i.e., 404 billion drs., represent deposits of Public Legal Entities, required by their charters.

(++) On the basis of the Cost of Living index compiled by the Bank of Greece