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Theodore Pelagidis\* and Taun Toay\*\*

# Expensive Living: The Greek Experience under the Euro

*Apart from its widely accepted direct advantages, the introduction of the euro has been widely perceived as causing a surge of inflation in most of the EU member states. Particularly in Greece there has been a decided shift in sentiment concerning EMU membership. Is the common perception among Greeks that the euro has been the primary cause of recent price hikes correct?*

Whether at the market, paying rent, or travelling, Europeans complain about rising prices and often attribute this to the adoption of the euro. No matter what language they speak, Europeans increasingly cringe at prices under the euro – support for which has eroded from the time of its introduction. A growing divide is apparent in Europe between the intended benefits of monetary union and the public discontent surrounding the reforms that accompany it.

This conflict can be seen particularly clearly in Greece, a society caught between integration and discomfort with the recent pace of change. In particular, although the majority of Greeks remain proponents of the European Union's widening and deepening, public disappointment over the euro is increasingly prevalent. Previously, Greece witnessed a hard push for inclusion in the European Monetary Union (EMU), from both policy-makers and citizens. Now, Greece is among the nations most opposed to the euro. The most recent Eurobarometer survey finds only 49% of Greeks in favour of the European Monetary Union, versus the 59% average for the EU. The figures are even more divergent when comparing the numbers of those against the EMU, where Greece boasts the second highest percentage (England: 64%; Greece: 49%; EU average: 35%). These figures are a far cry from the 62% of Greeks that favoured EMU membership in previous surveys.<sup>1</sup> Such a rapid shift in sentiment warrants exploration.

The European Commission claims that the overall effect of the changeover on prices was limited, with the "all items" category of the "Harmonised Index of Consumer Prices" falling between 0.12% and 0.29% – depending on the country.<sup>2</sup> In fact, the overall Consumer Price Index (CPI) in Greece rose cumulatively only by

20.1% over the six-year period of 2000 to 2005.<sup>3</sup> Many people are quick to attribute this seemingly stark figure to the adoption of the euro – understandably, as the entrance of Greece into the European Exchange Rate Mechanism (ERM) and later into the eurozone nicely corresponds to this time period. Overlooked, however, is the same comparison for the six years preceding 2000. Cumulative inflation for 1994 through 1999 was 40.9%. Far more staggering is the comparison to the six years preceding 1994 (an astonishing 97.4%). In brief, recent levels of inflation in Greece pale in comparison to previous chapters of Greek history (cf. Figure 1).

However, the real concern is not the *overall* inflation rate. It is often argued that the harmonised inflation index disguises enormous price hikes. Most observers acknowledge that the changeover to the euro precipitated price increases in certain sectors and for specific goods and services of everyday consumption such as coffee, vegetables, bread, newspapers, haircuts, local taxes (including parking meters) and so on.<sup>4</sup> These price hikes are regularly matched with the "slow growth" or even stagnation of wages, for unskilled labour in particular (cf. Table 1 for minimum wages), a possible consequence of increasingly open labour markets, trade globalisation and a growing supply of ready-to-work labour, mainly due to high rates of unemployment.

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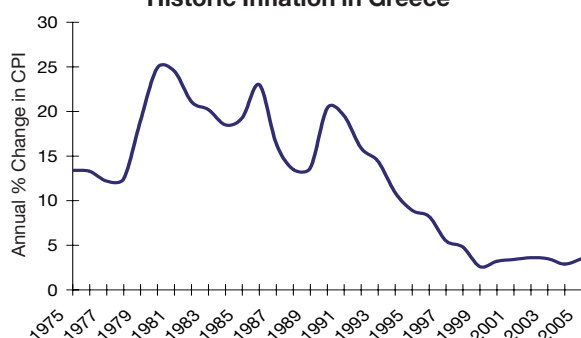
<sup>1</sup> Elliniko Kentro Eypopaikon Meleton (EKEM): European Developments: The Greek View, in: Newsletter, No. 10, September 2005, University of Athens Institute of European Integration and Policy and the Hellenic Centre for European Studies.

<sup>2</sup> European Commission: The Euro: Our Currency, at: [http://europa.eu.int/comm/economy\\_finance/euro/faqs/faqs\\_16\\_en.htm](http://europa.eu.int/comm/economy_finance/euro/faqs/faqs_16_en.htm) (last accessed: October 24, 2005).

<sup>3</sup> National Statistical Service of Greece (NSSG): Evolution of the 12-month Rates of Change of Overall CPI, during the Years 1959-2005, at: [www.nssg.gr](http://www.nssg.gr) (last accessed: December 12, 2005).

<sup>4</sup> European Parliament, Committee on Economic and Monetary Affairs: Report on the implementation of an information and communication strategy on the euro and Economic and Monetary Union, Session Document Report, 11-12 June 2005.

**Figure 1**  
**Historic Inflation in Greece**



Source: National Statistical Service of Greece and Ministry of Finance.

**Table 1**  
**Minimum Statutory Wages and Salaries**

	Minimum daily wage of blue collars (grc) <sup>1</sup>	Minimum monthly salary of white collars (grc) <sup>1</sup>	Minimum monthly salary average for Eurozone <sup>2</sup>
2000	20.7	461.5	848.6
2001	21.1	469.7	890.0
2002	22.2	494.8	923.0
2003	23.3	519.9	951.6
2004	24.5	547.6	979.8
2005	25.9	579.0	1019.6

Sources: <sup>1</sup> Bank of Greece and General Statistical Service of Greece. <sup>2</sup> Eurostat 2005 – averages are for the eurozone nations with a minimum wage: Belgium, France, Greece, Ireland, Luxembourg, Netherlands, Portugal and Spain.

This paper aims to explore whether or not the common perception among Greeks that the euro has been the primary cause of recent price hikes is sound. We deal with five relevant central explanations to approach the issue. First, we examine the extent to which any recent inflation trends are attributable to the constraints imposed by monetary union and the single currency, namely negative demand disturbances in certain Greek regions. Second, we question to what extent these patterns are also due to the adoption of the euro – including conversion period issues – versus domestic product market rigidities. Third, we investigate the impact of strong seasonal effects on inflation, in the context of the traditional Greek “petit bourgeois capitalism” that still survives despite some Europeanisation of the economy. Fourth, we explore the extent to which unemployment is another factor that drives wages and purchasing power down. Last but not least, we apply the Balassa-Samuelson effect to see whether it constitutes the culprit for price hikes of non-tradable products.

**Theoretical Underpinnings of Optimal Currency Areas and “Expensiveness”**

In theory, monetary union entails a host of benefits for the countries concerned. Most importantly, the single currency promotes trade by reducing uncertainty over interest and exchange rates, and by eliminating transaction costs and red tape by the banks. In addition, a single currency provides better access to markets for European enterprises, both within the European Union and outside of it, thus helping to improve their competitiveness – again, theoretically, as the opposite has been observed in Greece. It *should* also benefit consumers by increasing price transparency and competition. These benefits of the single currency were thought to be potent enough to boost the growth of the European economies. Reality, however, turned out to be quite different.

The main criticisms of the single currency originate from the theory of “optimal currency areas” (OCA), which argues against a common monetary policy.<sup>5</sup> The basic premise is that the mobility of factors of production is a fundamental requirement for a successful currency area. This would inject sufficient flexibility into the system to hedge against asymmetric demand shocks. In truth, however, the mobility of labour remains low across Europe – not to mention the absence of a uniform and timely transfer payment system.<sup>6</sup> This makes adjustment in response to exogenous shocks slow, incomplete and asymmetric, leading to considerable output and employment losses for certain regions and sectors under a one-size-fits-all monetary policy.

In particular, the incidence and magnitude of aforementioned demand disturbances ultimately depends on the output mix and degree of specialisation across countries and regions. This, in turn, tends to undermine the OCA. The EMU in itself tends to create convergence but, at the same time, it also tends to deepen market integration. This increases the degree of sector specialisation and reinforces differences in the structure of production. The greater the differences in the structure of production, the greater the incidence and magnitude of demand shocks on individual countries and regions. Thus, the lower the respective speed of adjustment. The rigidity of labour and product markets only aggravates the problem.

Within the EU there are marked differences in the structure of production. Germany and France, for instance, have relatively large manufacturing sectors.

<sup>5</sup> T. Pelagidis: OCA Approach and the Third Stage of EMU. A Review of Recent Evidence, in: *International Review of Economics and Business*, Vol. XLIII, No. 4, 1996, pp. 759-790; T. Pelagidis: Divergent Real Economies in Europe, in: *Economy and Society*, Vol. 26, No. 4, 1997, pp. 546-559.

<sup>6</sup> T. Pelagidis: Europe at a Monetary Crossroads: Problems and Prospects, in: *Cahiers Economiques de Bruxelles*, Vol. 39, Issue 4, No. 152, 1996, pp. 451-486.

Conversely, the manufacturing sectors of Greece and Portugal are very small, accounting for equally small employment ratios. One would not expect a demand shock to affect these countries in the same way.

Differences in the composition of output from one country to another mean that terms of trade shocks affect countries differently. Hence, loss of domestic control over monetary policy tends to make macroeconomic shocks more asymmetric.<sup>7</sup> In fact, empirical evidence shows that the core EU countries (Germany, France, the Netherlands and Denmark) experience very different supply shocks from those affecting other member countries, including the UK, Italy, Spain, Ireland, Portugal, and Greece,<sup>8</sup> meaning that even the EU-15 alone is prone to asymmetric shocks. Extending the analysis to countries as economically diverse in their composition as the EU-25 leaves policy-makers with a group of nations that are anything but homogeneous.

Within the EMU, monetary policy is entirely in the hands of the ECB and outside the control of national monetary authorities. Hence, an adverse demand shock is expected to have a heterogeneous impact on member states and regions. The heterogeneous impact will be more pronounced as economic integration promotes specialisation and the deepening of production.

The internal cost of adjustment will depend on the size and incidence of asymmetric shocks and on the efficacy of alternative adjustment mechanisms, namely labour markets and fiscal policies. This means that the country affected must deflate internally, which means that wages should lag inflation to prevent a loss of competitiveness. On the other hand, the corresponding required fiscal contraction raises regional unemployment and, as a consequence, the supply of the unemployed and unskilled in the labour market. Thus, overall wages stagnate for the “unprivileged” sectors and regions while at the opposite end of the spectrum the winners concentrate wealth, demanding superior, modern products and services. At this point – despite theoretically greater market efficiency – the introduction of the euro creates favourable conditions for growing inequalities in incomes and eroding standards of living. In other words, winners (agents and regions) see their purchasing power increasing, while losers (other regions and mainly poor, unskilled labour and low-income pensioners) see their income stagnating, experiencing higher prices even for some

basic – albeit highly demanded – goods and services. As Greece’s structure of production and employment, and its general division of labour, is quite different from the EU average (due to the relatively high share of GDP stemming from the agricultural and petit-professional sectors), any demand shocks in the European economy are likely to be experienced in Greece as both asymmetric and negative, with disastrous results for Greek purchasing power.

We shall go further and examine the above argument in the context of the Balassa-Samuelson effect later. First we must discuss another channel with which the euro and its “asymmetrical consequences” might contribute to “expensive living” in Greece, namely product market rigidities that allow price abuses to flourish.

### Conversion Period and Domestic Product Market Rigidities

While it could be argued that the terms of entry and constraints of the eurozone place upward pressure on prices, our attention should focus on the changeover period. It is clear that there was some rounding up in the conversion process to the euro. While the official conversion rate was enforced at the exchange and banking level, new prices for goods and services were left to providers – offering a convenient opportunity for price gouging.

Beyond the sectors that could claim menu-cost pricing strategies, many of the less formal markets draw the greatest complaints of price hikes. Unfortunately, due to the discretion exercised by sellers and the lack of consistency in such informal markets, these areas are very difficult for economists and statisticians to track accurately (prices of goods bought at the *laiki*, or open-air market, for example). The range of price level changes is staggering, with some consumer groups claiming 20 to 147% increases in the price of certain goods since 2002.<sup>9</sup> Again, despite complaints over prices, there was not a sharp overall spike in prices at the time of conversion. That said, many trends are overshadowed when looking at the economy as a whole.

It should be noted that countries with more complex conversion rates witnessed higher inflation during changeover than those nations with easily calculated rates. The conversion period in the former, Greece included, created an information asymmetry between buyers and sellers. This mismatch in available information – or discrepancy in the cost of gathering accurate information – allowed a price wedge to be

<sup>7</sup> R. McKinnon: *Mundel, the Euro and OCAs*, Stanford University manuscript, 2000.

<sup>8</sup> B. Eichengreen: *EMU: Theory, Practice, and Analysis*, Cambridge 1997, Cambridge University Press.

<sup>9</sup> Greek Consumer Centre (ELKEKA): *Levels Cited from January 2002 through January 2006*, in: Kathimerini (English edition), 24 March 2006.

**Table 2**  
Inflation Rates in Greece

	March 2002	March 2003
Prices determined by the State		
Water/Sewage	3.1%	4.1%
Electricity	4.4%	3.9%
Medical services	4.9%	5.7%
Hospital stays	4.5%	4.4%
Hotel expenditures	12.7%	5.3%
Airline tickets	12.2%	0.0%
Taxi fares	0.0%	8.0%
Ferry tickets	6.1%	26.9%
Tuition fees	3.6%	4.5%
Prices determined by the market		
Take-away food	6.7%	3.8%
Books and Newspapers	3.7%	4.0%
Served beverages	8.4%	5.0%
Haircuts	11.0%	7.9%
Car services	3.2%	7.2%

Source: Alpha Bank: Economic Bulletin, No. 86, 2003.

driven between the buyers and the market clearing rates,<sup>10</sup> meaning the cost of converting the prices for many purchases was higher for buyers in countries with complex exchange rates to the euro. While marginal on aggregate, these changeover inflationary effects were especially pronounced in low-priced goods – an asymmetry to which we shall return. Equally pronounced, as Table 2 shows, was the inflation acceleration in services.

In particular, several goods and services in the Consumer Price Index stand out as showing accelerated inflation in the years surrounding the changeover to the euro (see Table 3). “Food and non-alcoholic beverages” along with “hotels, cafés and restaurants” witnessed inflation rates of 5.1% and 4.6% respectively for 2001 and 5.3% and 6.7% for 2002. Such figures are well above the economy’s average rate of 3.4% for 2001 and 3.6% for 2002. More pronounced was the acceleration in “alcoholic beverages and tobacco,” which soared by 7.6% in 2001 and 7.2% in the following year. This is in sharp contrast to a category such as “transport,” which boasted rates of 1.1% for 2001 and 0.9% for 2002.<sup>11</sup> While these accelerations in prices for certain categories correspond to the adoption of the euro, one should be careful before saying the new currency caused these trends. It is, however, reasonable to say that the areas marked by more rapid infla-

<sup>10</sup> M. Ehrmann: Rational Inattention, Inflation Developments and Perceptions After the Euro Cash Changeover, Working Paper Series No. 588, February 2006, European Central Bank.

<sup>11</sup> NSSG: Monthly Sub-indices of Groups of Items of CPI 1999-2005, November, at: www.nssg.gr (last accessed: January 17, 2006).

**Table 3**  
CPI Sub-indices Inflation (%)

	2000	2001	2002	2003	2004
General Index	3.2	3.4	3.6	3.5	2.9
Food and Beverages	1.9	5.1	5.3	5.0	0.5
Alcohol/Tobacco	2.8	7.6	7.2	4.2	4.6
Garments and Footwear	2.1	3.3	3.6	2.0	4.1
Housing	6.1	1.8	3.3	4.4	4.8
Durable goods	1.0	2.3	1.6	2.0	1.6
Health	3.3	2.9	4.7	4.3	4.6
Transportation	6.4	1.1	0.8	3.0	3.5
Telecommunications	-10.5	-0.8	-4.6	-4.2	-4.3
Leisure and recreation	1.3	3.5	3.3	2.9	2.8
Education	3.2	3.6	3.9	4.5	4.4
Hotels, cafes & restaurants	4.7	4.6	6.7	4.8	4.2
Other goods and services	2.2	4.9	3.6	3.2	2.2

Source: National Statistical Service of Greece (NSSG), various issues.

tion surrounding the adoption of the euro had a high degree of flexibility in determining prices under the new currency.

While it is clear that there was a mix of accelerated inflation for certain goods and services surrounding the adoption of the euro,<sup>12</sup> those same years were marked by historically low inflation rates for Greece (cf. Figure 1). How, then, can we explain the prevalence of the view that the euro has caused higher prices? The answer lies, as we shall argue below, to a great extent in product market rigidities, which institutionalise any temporary effects such as the conversion one-off changeover.

If the truth be told, inflation remains problematic in Greece today for many of the same reasons that it was troublesome in the past. Strong unions, especially in public sectors, successfully demand wage hikes beyond levels that productivity gains would otherwise allow.<sup>13</sup> Furthermore, restrictions on hiring and firing employees drive up the cost of taking on new workers. These costs are easily passed on to the consumer in Greece due to fairly uncompetitive markets. The lack of open markets and excessive regulation further impedes competition from driving down prices. It should be pointed out here that Greece’s economy is the least “trade open” among the EU member states, with trade only 15% of GDP (openness index).<sup>14</sup> That makes the

<sup>12</sup> Alpha Bank: Inflation and Competitiveness, in: Economic Bulletin, No. 86, June 2003, pp. 15-23.

<sup>13</sup> R. McDonald: The Competitiveness of the Greek Economy, Athens 2005, Athens News.

<sup>14</sup> National Council for Competitiveness and Development (NCCD): Annual Report for Competitiveness, Athens 2006, NCCD.

**Table 4**  
**Composition of Regulation Indices**

	Lawyers	Notaries Public <sup>1</sup>
Austria	7.3	5.0
Belgium	4.6	4.3
Denmark	3.0	--
Finland	0.3	--
France	6.6	4.8
Germany	6.5	5.0
Greece	9.5	4.8
Ireland	4.5	--
Italy	6.4	4.3
Luxembourg	6.6	4.6
Netherlands	3.9	3.8
Portugal	5.7	3.9
Spain	6.5	4.0
Sweden	2.4	--
UK (E & W Barristers)	4.6	--
UK	3.5	--

<sup>1</sup> Arithmetic mean of market entry regulation indices.

Source: I. Paterson et al.: Economic Impact of Regulation in the Field of Liberal Professions in Different Member States, Final Report, Part 3, DG Competition (2003), EU. Emphasis added.

life of domestic monopolies much easier, as competition from abroad is rather restricted, but on the other hand it accelerates prices at the expense of consumer's welfare. It is worth mentioning that, according to Eurostat and National Bank of Greece estimations,<sup>15</sup> the "core inflation" (prices of fuel and fresh fruits and vegetables excluded) in Greece is around 3.0%, the highest by far in the EU (average 1.6%). Where fuel and vegetables are generally the main culprits of in-

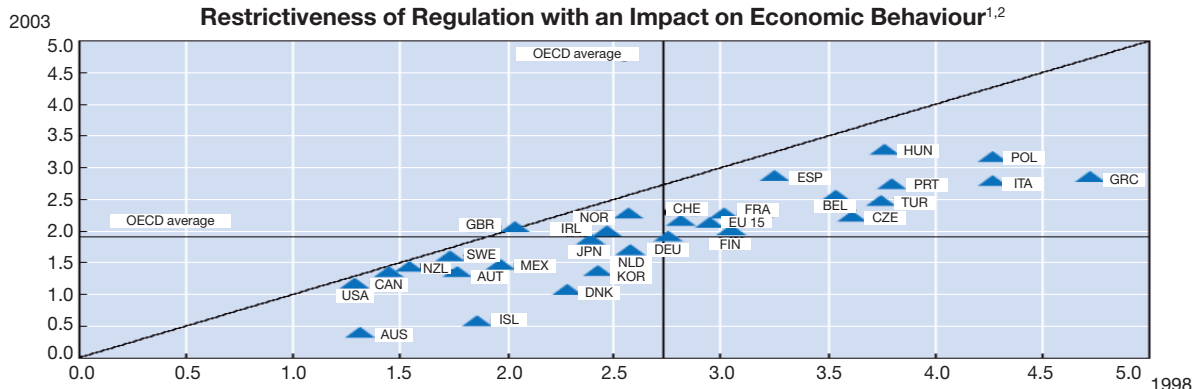
<sup>15</sup> National Bank of Greece: Press release, 14 November 2005, at: [www.nbg.gr/pr\\_release/](http://www.nbg.gr/pr_release/).

flation volatility, in Greece price hikes seem to result mostly from the malfunctioning of the product markets and, to a lesser extent, to the Balassa-Samuelson effect, as standard macroeconomics would suggest.

Let us first embark on the issue of the uncompetitive markets and excessive regulation. In fact, the two impetuses are closely connected. Stagnation in Europe is often largely attributed to labour market rigidities, namely, too high unemployment benefits, too high minimum wage levels, and too high a degree of worker protection, whereas the oligopolistic structure of certain markets and the strong and inefficient presence of the state tend to be overlooked. Focusing on labour rigidities alone, however, misses a major explanation of inflation owed to product and service rigidities. Table 4 lists indices that capture the level of regulation in two professions for various EU countries. A certain level of regulation can be viewed as necessary to protect consumers. Nevertheless, at high levels regulation becomes a deterrent to new market entries, allowing insiders to drive up prices and offering little incentive for improving services or productivity performance. Notice the correlation between less regulated countries and employment, with Finland, Sweden, and the UK displaying comparatively low regulations versus the stagnating economies of "old Europe." Furthermore, while Greece displays strong growth rates, it also boasts very high levels of unemployment.

Figure 2 shows the negative externality of such excessive regulation on economic activity. While Greece displayed an improvement from 1998 to 2003, it still ranks worse than any other EU15 country. In addition, Figure 3 places Greece at the top regarding discriminatory procedures, which represent a strong impetus to competitive market function. An interesting observation

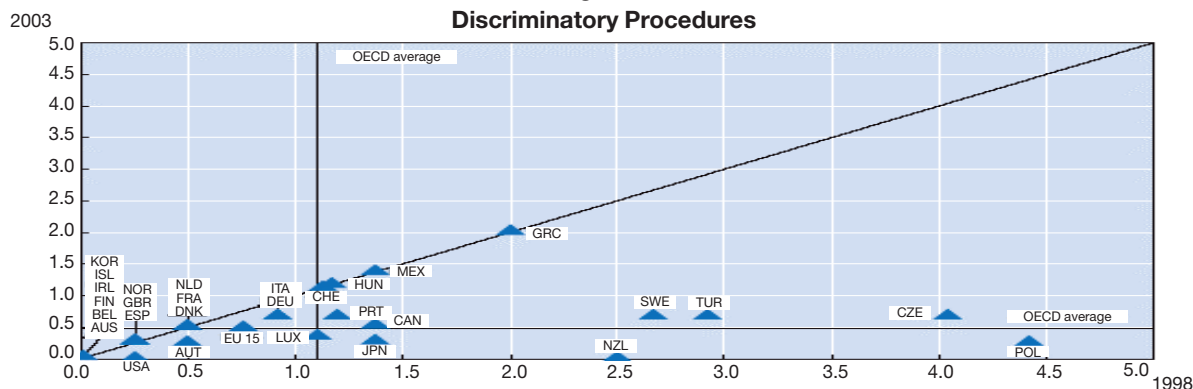
**Figure 2**  
**Restrictiveness of Regulation with an Impact on Economic Behaviour<sup>1,2</sup>**



<sup>1</sup> EU15, excluding Luxembourg. <sup>2</sup> Economic regulation includes all domestic regulatory provisions affecting private governance and product market competition such as state control and legal barriers to entry in competitive market.

Source: OECD: Economic Policy Reforms: Going for Growth, 2005.

Figure 3  
Discriminatory Procedures



Source: OECD: Economic Policy Reforms: Going for Growth, 2005.

is Greece's improvement regarding restrictive regulation impacting on economic behaviour versus no improvement as regards discriminatory procedures. One possible explanation is that restrictions have not eased; rather, strong growth in Greece and the investment preceding the Olympic Games in 2004 offset the otherwise negative impact on behaviour. The figures should raise the alarm for policymakers. Unfortunately, the degree of regulation and discriminatory procedures is both a cause and a product of the state's occasionally serving clientelistic pressures.<sup>16</sup> Regulation creates insiders who are then better leveraged to influence liberalisation – or a lack thereof – in industries and services.<sup>17</sup>

In conclusion, government regulation should focus on fighting firms' rent-seeking behaviour that is directly linked with product market rigidities and "entry to the market" restrictions. Such restrictions are the direct result of the influence of special interests in entrepreneurial activities and professions that exercise pressures to keep significant parts of product and service markets under oligopolistic controls, favouring price increases which reduce consumer welfare and purchasing power. Thus, the government concern should revolve around regulating price abuses and liberalising product and service (professional) markets. Seemingly, one way to facilitate this is to ease regulations on professions and the hiring burdens of companies. Again, markets more open to competition through lower barriers to entry will promote hiring as well as drive prices lower.

### Strong Seasonal Effects and Other Domestic Issues

While the euro fostered information asymmetry – and, consequently, price gouging – during conversion,

it also allowed for the exacerbation of a pattern we term the "Pasha Effect".<sup>18</sup> The "Pasha Effect" refers to price discrimination surrounding traditions. The implications of this effect are found during periods in which producers price gouge certain products favoured by tradition. The application to Greece revolves around religion's role in society and seasonal consumption patterns dictated by a Mediterranean diet – as opposed to high consumption levels of processed foods. In effect, Greek consumers are almost always subject to some "seasonal effect," with the tradition of shopping at the *laiki* for fresh produce, or dietary restrictions for Easter and Christmas. This "Pasha Effect," along with often unfavourable weather conditions that damage perishable vegetables and fresh products, allows price hikes to precede demand and supply movements, given the changing nature of consumer demand elasticity over periods of tradition-constrained consumption patterns. While not necessarily unique to Greece, the "Pasha Effect" is likely to be more observable in any society where tradition has a strong influence on free-market mechanisms. Although the folly of this effect lies in rigid product markets where producers can easily exploit periods of inelastic demand allowing for price discrimination, the conversion to the euro probably allowed the Pasha Effect to appear less pronounced – lost in conversion, if you will. The fact that the "Pasha Effect" has continued long after the

<sup>16</sup> P. Kazakos: *Between the State and the Market*; Athens 2001, Paktakis Publishing.

<sup>17</sup> Y. Stournaras: *Price Levels and Expensiveness in Greece*, in: *Eleftherotopia*, 7 August 2004, www.ppol.gr.

<sup>18</sup> "Pasha" (Easter) refers to Orthodox Easter in Greece, prior to which a 40-day fasting period takes place. There are fairly strict dietary guidelines over this period, with a notably increased consumption of vegetables and certain seafoods and, following Easter, lamb. Other similar – although shorter – periods contributing to price run-ups in certain goods and services exist. Other notable "special food periods" that prohibit or favour the consumption of certain foods and products are the "first day of Lent," the 15th of August (Assumption), the 1st of May (Labour Day), Christmas, New Year's Day, and last but not least, the Sunday-Pasha. During the summer holidays in August, the price of ferry and other transportation tickets also accelerate very rapidly due to the huge domestic and international seasonal demand for travel to the islands.

conversion to the euro is an indication of the lack of free market forces in Greece.

While a great deal of the explanations for the euro's perceived contribution to inflation revolves around socioeconomic trends – namely, that more people are feeling greater burdens from inflation compared to previous generations – mention should be given to psychological forces. Psychology plays a strong role in the perception of prices, as people factor the smaller everyday costs – such as coffee and parsley – more readily than the rarer purchases, in particular by the less privileged, of computers and cars, or the interest rates savings they have on a home loan.

This divergence between perceived inflation and actual inflation is partially attributable to relating successions of price hikes to a single event. Some limited panel research for restaurants in Italy has found that much of the inflation came before the official euro changeover. The perception of prices doubling often relates several years to the conversion date and is deemed so large due to a number of price revisions.<sup>19</sup>

The importance of these trends and their impact on public perception is that they are often strictly attributed to the euro. As we argued above, it is true that the euro created a conversion price shock and this period was plagued with “price discrimination” that extended beyond the changeover period. Furthermore, the continued “seasonal effects” in their different forms in Greece have probably had a real impact on inflation; however, “conversion,” as well as “seasonal,” impacts became extended well beyond conversion and entrenched price hikes due to producers' power and were fuelled by rigid product markets. It follows that higher prices and eroded purchasing power help explain the strong public discontent over the euro, as many people believe that the single currency is the culprit. Nonetheless, apt blame for recent price trends should focus more on the structural forces that perpetuate inflation.

### The Underprivileged Unemployed

By looking at purchasing power relative to other European nations, Greece lacks rapid real convergence,<sup>20</sup> meaning Greece has not created a much higher standard of living for its citizens – especially for the unemployed and underemployed – since joining the European Union, despite structural fund transfers. Those socially marginalised in the integration process

are especially prone to populist rhetoric and scapegoating the euro for stagnated wages and high rates of unemployment.

Standard of living indices often look at purchasing power levels over a period of time. In the past, money in Greece rapidly lost value, but was offset by large wage increases – fuelling the inflation cycle of higher prices and higher wages. Today, inflation has been dramatically reduced but so, too, has wage growth. Further, while wage hikes continue to outpace inflation overall, wage growth in lower income jobs is often below the appropriate inflation rate for these income groups,<sup>21</sup> as the unskilled labour supply has massively increased due to the one million unskilled immigrants who have entered the country in the last decade or so. These trends, coupled with already highly entrenched unemployment, leave more people feeling greater impacts from price hikes.

Unemployment, with some interplay from trade and labour globalisation,<sup>22</sup> is certainly one of the factors exerting downward pressure on wages. Greece only trails Germany in overall unemployment, at 9.7%, and long-term unemployment, at 5.2%.<sup>23</sup> These stubbornly high rates of unemployment exacerbate the burdens of inflation for different segments of the population. Greece boasts the eurozone's highest percentage of unemployed individuals under 25 years old, at an unsettling 25%. For ages 25 to 29, the unemployment rate is 16%. The unemployment of women is also shockingly high, with an astonishing 27% of those between ages 15 and 29 unemployed. One would expect these groups to be the demographics driving growth. The problem is not constrained to new job seekers either. For women between 30 and 44, the figure is 14.9%.<sup>24</sup> Such stark figures indicate a large mismatch between skills and available jobs. Compare this environment to 1981, when Greece joined the EU and enjoyed unemployment rates of around 4%.

Furthermore, it is not only that jobs are more difficult to acquire, but also that the pay scale is low by recent standards due to the globalisation of trade and immigration's further increasing the labour supply in the domestic markets. The minimum wage in Greece is little over half of the average of other euro nations

<sup>19</sup> E. Gaiotti, F. Lippi: Pricing Behaviour and the Introduction of the Euro: Evidence from a Panel of Restaurants, Discussion Paper No. 4893, October 2004, Centre for Economic Policy Research (CEPR).

<sup>20</sup> OECD: Economic Survey of Greece, 2005, Policy Brief, Paris, July 2005, OECD.

<sup>21</sup> Bank of Greece: Annual Report 2003, Athens 2004, Bank of Greece.

<sup>22</sup> G. Chortareas, T. Pelagidis: Trade Flows: A Facet of Regionalism or Globalization?, in: Cambridge Journal of Economics, Vol. 28, No. 2, 2004, pp. 253–271.

<sup>23</sup> Greece's long-term Jobless Rate still among EU's Highest, in: Kathimerini (English Edition), 5 January 2006.

<sup>24</sup> NSSG: Population of 15 years and Over by Employment, Age, and Sex: 1998-2005, Labour Force Survey, at: www.nssg.gr (last accessed: March 9, 2006).



**Table 5**  
**Unemployment Rate**

2002	2003	2004	2005	2006
10.9%	10.4%	11.0%	10.4%	9.8%

Source: Alpha Bank: The Greek Economy, Short-term Economic and Financial Outlook. No. 56. June 2006.

(cf. Table 1), with Greeks claiming Euro 668 a month, compared to the average Euro 1019.6 and a far cry from the UK or Luxembourg levels of Euro 1244 and Euro 1467 a month, respectively.<sup>25</sup> Equally troubling is that to obtain the same goods, an average Greek must work 92% more than an average German worker by some measures.

Research at the Bank of Greece recently looked at the effects of inflation on different income groups in Greece.<sup>26</sup> Underlying the report are the different consumption patterns that separate socioeconomic groups display. Naturally, a low-income individual will devote a greater percentage of his or her income to primary products such as fruits, vegetables, and other foods. The same individual will spend less on other areas of the CPI such as entertainment, leisure and restaurants. It follows that the unemployed, pensioners, farmers and the poor are particularly sensitive to inflation in Greece. Furthermore, over most of the period under examination, these groups faced inflation well above the average rate.

These trends contribute to a negative perception of the euro in general. As we argued, those most burdened by inflation have been, until very recently, a rather growing segment of the population. Greece has witnessed many of the changes that follow Western Europe: weakened labour rights, high unemployment, constrained state spending etc. Still, the nation has yet to reap the income gains of a country like Ireland, which joined the EU after Greece and now enjoys a living standard higher than the EU average.

#### **The Balassa-Samuelson Effect**

Greece today is still less developed than other eurozone countries. At the same time, it shows greater rates of growth and, simultaneously, higher rates of inflation than other member states. Consequently, it is worth studying whether the Balassa-Samuelson (B-S) effect can be applied to Greece to explain the rela-

tively high rate of inflation and, as a consequence, of “expensiveness.”

In accordance with B-S theory, Greece’s tradable sector, in the common market context, is facing the pressure of competition and, as a consequence, its productivity is rising. The resulting increase in exports drives the tradable sector’s wages up. This wage increase is not inflationary, as productivity follows equally and offsets inflationary pressure within the sector. However, higher wages are spent on both tradable and non-tradable products (services) that are not facing international competition. A typical example of such services is hairdressers. In accordance with the B-S effect, although productivity is not enhanced in hairdressing and as the increased demand is not counterbalanced by a rise in quantity or quality of the offered service, the result is higher priced hairdressers.

In the case that the B-S effect holds for Greece, one must first demonstrate that inflation pressures are solely derived from the sectors of the economy which produce non-tradable goods. However, in both the tradables and non-tradables sectors there do not appear to be other relative price reductions, with the exception of telecommunications, in which free-market competition prevailed. It is also noted that divergence is observed between Greek and eurozone inflation rates in both the tradable and non-tradable sectors (Figures 4 and 5).

A second reason that the B-S effect can only offer a partial explanation of recent Greek inflation is that a significant increase in income flows from abroad is missing, as the tradable sector’s exports tended to stagnate (10% of GDP in 2000, 7.5% of GDP in 2004, although their average annual increase during the period of 2001 through 2005 was only around 2.3%, excluding oil).<sup>27</sup> For the B-S effect to hold in Greece’s case, there should have been a well-observed increase in exports due to higher domestic productivity. Although we are witnessing an increase in FDI for the 10 new member states, Greece is an exception to this tendency. In both categories – exports and FDI – what is missing for Greece is a significant increase in receipts and inflows that are of such a magnitude that it would justify a typical (100%) Balassa-Samuelson effect.

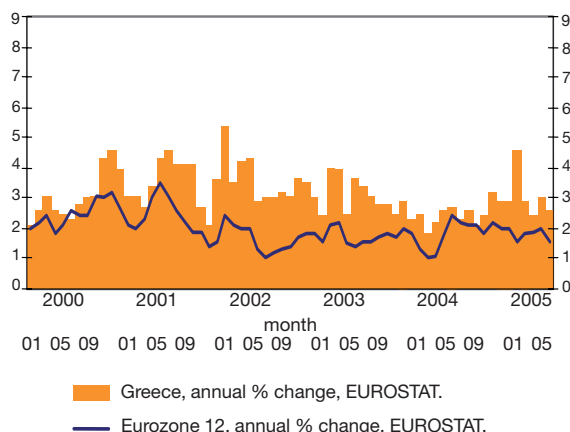
On the other hand, as previously mentioned, there are important inflows from the EU in the form of structural funds, as well as Common Agricultural Policy funds, which in total come to about 3% of the GDP, substituting to an extent for the missing FDI. This is

<sup>25</sup> Eurostat: Monthly Minimum Wages—Member States and Candidate Countries, Eurostat. 2006; P. Regnard: Minimum Wages 2005: Major Differences between EU Member States, in: Statistics in Focus, 2005.

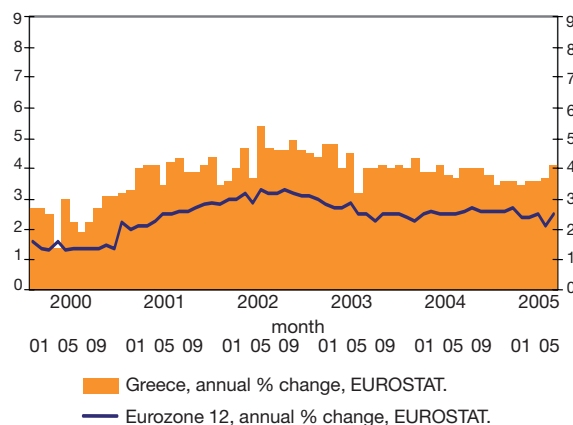
<sup>26</sup> T. Mitrakos, S. Zografakis: The Redistributive Impact of Inflation in Greece, in: Economic Bulletin, No. 24, January 2005, pp. 45-82, Bank of Greece.

<sup>27</sup> NSSG: Monthly Sub-indices ... , op. cit.

**Figure 4**  
Inflation Rates, Goods



**Figure 5**  
Inflation Rates, Services



perfectly illustrative of what we refer to as a “quasi B-S effect.”

EU funds are, in truth, enough to increase domestic demand significantly and, consequently, prices of non-tradable services that avoid – by definition – the competitive pressures of open markets. An expansionary fiscal policy that revolves around the Maastricht limit of 3% of GDP according to the methods used to measure deficits also contributes to increasing domestic demand and favours further price hikes. In the same direction, inflows from the huge “shadow” economy (around 30% of the official GDP) contribute to “expensiveness” through massively increasing demand for certain products, especially non-tradable services that show weak increases in productivity rates.

A third cause for constraint in fully attributing Greek trends to B-S theory is the lack of a significant rise in the productivity of certain sectors of the economy, such as tourism and transportation, that generate income from abroad. However, the impact of both EU structural funds and the expansionary fiscal policy may reflect some general increases in domestic productivity of around 2% annually. It has to be noted that these increases are only superficially in accordance with the B-S effect, as EU structural fund transfers and fiscal expansion – not effective resource allocation – increase GDP and, subsequently, artificially increase the productivity rate (GDP/person).

**Concluding Remarks**

Greeks’ disappointment and frustration over the euro is understandable. It is clear that Greece is a more expensive place to live after the euro. Gone is the drachma, and with it, a certain sense of national autonomy. The euro is the embodiment of the changes in Greek society, changes that have left many losers.

Labour disputes have entered a new realm of desperation, where unions are torn between honouring their constituents and ceding some of the inevitable concessions in a globalising world. In addition, the notion of European integration as the road to higher standards of living has not come to bare fruit for the majority of Greeks.

In this paper we have dealt with five relevant central issues to approaching inflation in Greece. First, we examined the extent to which recent inflation trends are attributable to the constraints imposed by monetary union and the single currency, namely negative demand disturbances in certain Greek regions. Second, we investigated to what extent these patterns are also due to the adoption of the euro – including conversion period issues – over domestic rigidities such as strict product market regulations. Third, we investigated the impact of strong seasonal effects on inflation, in the context of the Greek traditional quasi-capitalism that still survives despite some modernisation of the economy. Fourth, we explored the extent to which unemployment is another factor that drives wages down. Last but not least, we applied the Balassa-Samuelson effect in order to assess the theory’s explanatory power for higher prices – in particular of non-tradable services.

We found that all the aforementioned factors play a role, although with different weights. Asymmetric disturbances contribute mainly to the phenomenon of both high prices and stagnating wages, especially for labour and regions hit by negative demand shocks. As expected, some “expensiveness,” especially concerning non-tradable services, is also attributable to the Balassa-Samuelson effect. However, the greater part of “expensive living” is argued to be a result of

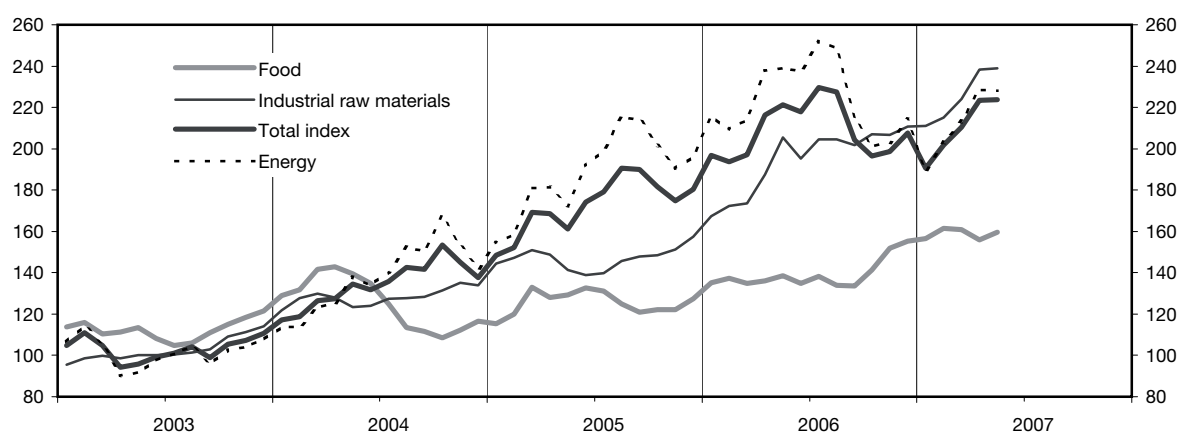
domestic issues, such as strong seasonal effects and product market rigidities. We considered the latter to be the most important factor. Henceforth, we argued that freeing companies from excessive regulations while monitoring price abuses would go far in breaking the oligopolistic nature of many Greek industries. By opening markets to competition while easing hiring burdens, the government can help stimulate formal economic activity, create jobs, support wages, and drive down artificially high prices.

Membership in the EMU carries with it an acknowledgment of stability, both political and economic. This perceived stability is vital in drawing foreign and domestic investment funds, furthering growth and encouraging employment. Moreover, it is expected that further European integration should create price con-

vergence and ease inflation pressures as transaction costs are reduced and nations converge. Herein lies a major shortcoming in the expected gains from widening and deepening, especially in the case of Greece.

In conclusion, the solutions to the entrenched issue of domestic "structural expensiveness" will not come through scapegoating the euro or the EU. Rather, by implementing structural reforms that will benefit both economic effectiveness and social cohesion, while tailoring policies to mitigate the losses of those marginalised by Europeanisation and globalisation, real reform can be achieved. The single currency provides a convenient "cause" for the domestic structural inefficiencies encouraging inflation in Greece. In the end, as much as Greece's future lies in the EU, the solutions to the present lie at home.

### HWI/HWWA Index of World Market Prices of Commodities<sup>1</sup> (2000=100)



Commodity Groups <sup>1</sup>	2006	Oct. 06	Nov. 06	Dec. 06	Jan. 07	Feb. 07	Mar. 07	Apr. 07	May 07
Total Index	208.9 (20.9)	196.6 (8.2)	198.8 (13.8)	207.5 (15.0)	190.7 (-3.1)	201.6 (4.0)	210.5 (6.8)	223.5 (3.3)	223.8 (1.1)
Total, excl. energy	177.7 (26.6)	187.0 (33.2)	189.9 (33.5)	193.8 (30.6)	194.5 (23.4)	198.7 (23.0)	204.7 (26.6)	213.2 (24.1)	214.7 (16.0)
Food total	139.1 (10.8)	141.2 (15.7)	151.8 (24.3)	155.4 (21.9)	156.6 (15.8)	161.6 (17.7)	160.7 (19.1)	156.0 (14.7)	159.5 (15.2)
Industrial raw materials	194.6 (32.5)	207.0 (39.5)	206.6 (36.7)	210.6 (33.7)	211.1 (26.0)	215.0 (24.8)	223.9 (29.1)	238.2 (27.1)	238.9 (16.3)
Agricultural raw materials	129.1 (11.9)	130.8 (12.3)	132.6 (16.0)	138.6 (19.5)	146.2 (21.7)	149.3 (21.8)	149.9 (22.5)	156.8 (27.4)	158.8 (24.1)
Non-ferrous metals	240.4 (59.5)	269.6 (74.1)	266.9 (64.7)	269.6 (52.5)	253.9 (36.1)	258.6 (32.7)	274.2 (39.7)	301.5 (31.8)	304.5 (14.0)
Iron ore, steel scrap	267.1 (16.1)	266.6 (17.8)	266.0 (14.9)	267.4 (16.4)	289.8 (12.5)	294.0 (13.0)	310.3 (17.4)	311.7 (15.9)	302.1 (11.3)
Energy	224.0 (18.8)	201.2 (-0.1)	203.1 (6.6)	214.2 (9.3)	188.9 (-12.4)	203.0 (-3.0)	213.3 (-0.4)	228.5 (-3.9)	228.2 (-4.5)

<sup>1</sup> On a US dollar basis, averages for the period; figures in brackets: percentage year-on-year change.

Further information: <http://www.hwwi-rohindex.org/>