

Greece's Integration to EMU and Lessons for Turkey

Burak Gündođdu

Orkun Girban

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1. INTRODUCTION

This paper aims to evaluate the integration of Greece into EMU and derive lessons for Turkey.

Greece was the only country that was willing but unable to complete all the stages of the economic integration by 1999. The Commission and the European Central Bank were given the duty to check for the convergence criteria every two years or when Greece demanded to be investigated.

In the light of its achievements throughout the integration process, the council decided that Greece was able to meet the Maastricht Criteria, thus it became a part of the EMU. The council decided in 2000 that Greece was allowed to adopt EURO with the beginning of the year 2001.

Turkey, as being a candidate, is taken into consideration and lessons are drawn about the EMU integration process and its potential effects on the Turkish economy.

2. EMU AND THE MAASTRICHT PROCESS

After the greatest stock exchange crisis in 1929 and the devastating Second World War leaders of the world economy agreed on the idea that the reconstruction of a more stable world economy is only possible with more international cooperation. The first attempt serving this purpose was the Bretton Woods system, which was carrying the US dollar to a superior position in comparison to other national currencies. But this system failed to stabilize other currencies.

Monetary Union is started to be addressed as a crucial part of the European Integration in the Hague Summit in 1969. The following year, Werner report was published describing three stages to be completed in ten years leading to a European Monetary Union. But those stages couldn't be completed due to the failure in the "Snake in the Tunnel" system which was designed to limit the fluctuations of the European currencies against each other.

In 1979, European Monetary System was introduced with a new currency called ECU. Exchange rates of the European currencies were tried to be kept in a small margin about the ECU to diminish fluctuations.

When the European states formed a single market in 1985, it became clear that a single currency was needed to reach the economic goals of the union. Another three staged plan was made by Delors (1988) having the same final goal with the previous plans; a strong and stable European Monetary Union. In order to reach this objective member states were supposed to reinforce the coordination of their economic policies, meet some macroeconomic criteria to converge their economies and assign their monetary policy decisions to an independent European Central Bank (ECB).

The Treaty of The European Union explains the details of the integration stages and includes a list of economic convergence criteria, known as the Maastricht Criteria. In 1990, Member States started to improve the free movement of capital and central bank debts in order to complete the first stage. In the second stage (started in 1994), the Member States were started to be supervised by the Commission about their public financing and the European Monetary Institute (EMI) was formed, as a base for the ECB, advising the states about their central bank independencies and a single currency. The Member States were obliged to meet the Maastricht Criteria in order to move on to the third stage, which was planned to start in 1997 or 1999 depending on the readiness of the states. The European System of Central Banks and the Euro were planned to be put into use with the beginning of the third stage.

3.i. THE PROCESS OF GREEK EMU INTEGRATION:

At the time Delors Report was published in April 1989, Greece was experiencing political instability and deep economic failure causing serious concern for EU. This problematic period posed threat to the general success of the economic integration of EU, by being an obstacle on the way of major common objectives such as single market and EMU. In addition to that, drachma was not the part of EMS and was not seen to be ready either.

Greece had mainly three priorities; firstly not to be isolated form the EMU absolutely, secondly tried, with others, to establish a fund parallel to EMU to qualify to enter, and thirdly

saw EMU as a potential way for political gains in other intergovernmental negotiations (IGC) with respect to Turkey. Besides Greece employed the “golden rule” of government borrowing should only be for investment not consumption. Structural reforms to obtain market liberalization and independent central bank were needed.

For these purposes, three convergence and stabilization program were employed. Medium Term Adjustment Program (MTAP) 1991-1993, the Convergence Program (CP) 1993-1998 and the Revised Convergence Program (RCP) 1994-1999 MTAP and CP failed because of similar reasons some which are lack of political will to implement them, lack of organized plan and EMS crisis of 1992-1993 causing disturbance in the financial markets and recession in Europe. In 1993, the new government established RCP with the ultimate aim of fulfillment of Maastricht criteria by 1999 and the reconstruction of Greek economy. Compared to previous program RCP was quite successful in achieving these goals. (45-48, Mourmouras)

Beginning from 1995 the Central Bank of Greece employed hard drachma policy, where exchange rate was used as the major tool, announcing a target for the first time. The main objective was to promote deceleration of inflation and to attain this goal it set two intermediate targets: to limit depreciation of drachma against ECU to 3% and to reach a monetary expansion of a 7%-9% growth in M3. Central Bank aimed to decrease the inflation to 8% from 10.8% for the year 1995. All targets except for the inflation rate were reached in 1996. Similar targets were set for 1996 and 1997. In addition to a decrease in inflation rates, acceleration in real GDP growth is observed. After 1997 no targets for inflation were announced. Although the Central Bank tried to keep the exchange in some margin, the major attempt was towards the stability of price level, thus exchange rate moved outside the targeted margin of 2.5% of the central rate.

Finally, on 19 June 2000 the Council decided that Greece fulfills the necessary condition for the adoption of the single currency system from 1 January 2001 and Greece joined the Euro area on 1 January 2001.

TABLE 1: Macroeconomic Indicators for Greece, EU(15) and EU(25)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Inflation											
Greece	5.5	4.5	2.2	2.9	3.7	3.9	3.5	3	3.5	N/A	N/A
EU(15)	1.7	1.3	1.2	1.9	2.2	2.1	2	2	2.1	N/A	N/A
EU(25)	2.6	2.1	1.6	2.4	2.5	2.1	1.9	2.1	2.2	N/A	N/A
Real GDP Growth											
Greece	3.6	3.4	3.4	4.5	5.1	3.8	4.8	4.7	3.7	3.4 ^(f)	3.4 ^(f)
EU(15)	2.6	2.9	3	3.9	1.9	1.1	1	2.3	1.4	2.0 ^(f)	2.2 ^(f)
EU(25)	2.7	3	3	3.9	1.9	1.2	1.2	2.4	1.6	2.1 ^(f)	2.4 ^(f)
GDP/capita											
Greece	71	70	71	73	73	77	81	82	84 ^(f)	85 ^(f)	86 ^(f)
EU(15)	109	109	110	110	110	109	109 ^(f)	109 ^(f)	108 ^(f)	108 ^(f)	108 ^(f)
EU(25)	100	100	100	100	100	100	100	100	100	100	100

Source: Eurostat

3. ii. IMPACTS OF EMU ON GREECE: COSTS AND BENEFITS

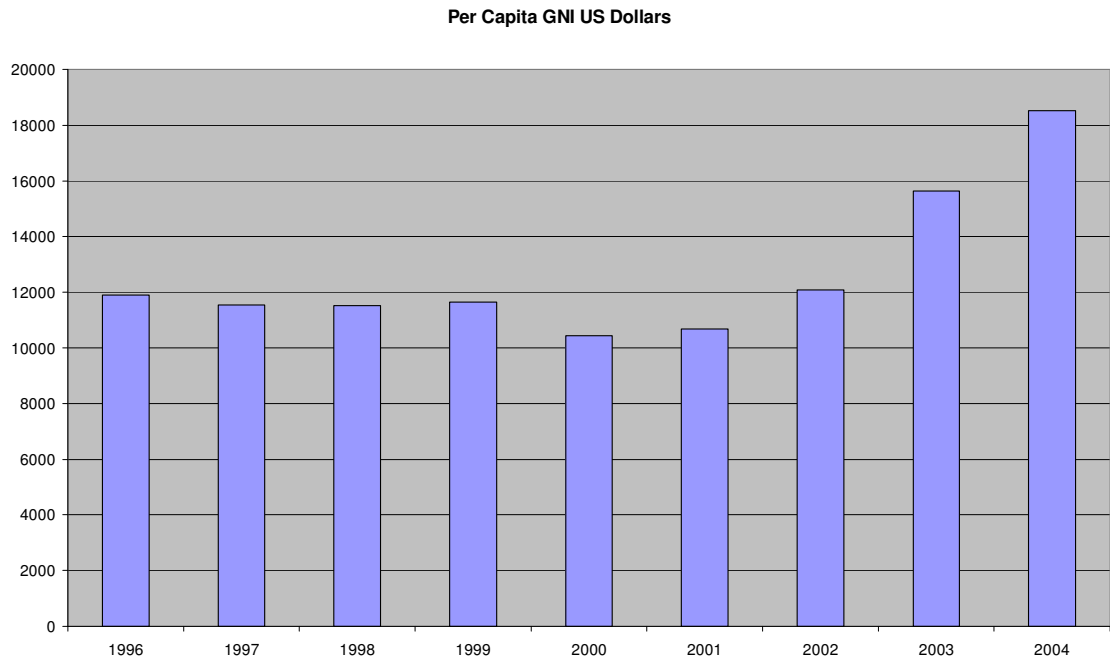
It is difficult to isolate EMU's effect on the European States from other effects, notably from globalization, the single market and rapid technological change. (Tavlas 2004)

A major benefit from participating in the EMU, especially among countries such as Greece, Spain, Portugal and Italy that have had recent histories of relatively high inflation rates has been the credibility gain derived from the elimination of the inflation-bias problem of the discretionary monetary policy. (Barro and Gordon 1983)

TABLE 2: Macroeconomic Indicators for Turkey

Turkey											
Inflation	82.1	82.1	61.4	53.2	56.8	47	25.3	10.1	8.1	N/A	N/A
Real GDP Growth	7.5	3.1	-4.7	7.4	-7.5	7.9	5.8	8.9	7.4	5.2 ^(f)	5.1 ^(f)
GDP/capita	32	32	29	30	26	26 ^(f)	27 ^(f)	29 ^(f)	30 ^(f)	30 ^(f)	31 ^(f)

Source: CBRT



GRAPH 1: Per Capita GNI of Greece in US Dollars

Source: United Nations Statistics Department

Greece has experienced high growth rates since 1999. Although we cannot conclude that better macroeconomic indicators are purely due to accession to EMU, we cannot neglect its contribution to the change in the figures.

The main effects of the EMU membership on Greece can be classified as follows. Firstly and most important of all, is the increase in the credibility of Greece which had decreased the expectations of long term inflation as the risk diminished and the expected fluctuations smoothed. These lead to an increase in the volume of trade and foreign direct investment.

As interest rates decreased and the economy became more stable, borrowing from domestic and international sources became much easier. Due to the fall in the debt stocks coupon rates fell. The guarantee and the support of the European Central Bank has been a strong reference for Greece which lead to more successful implementation of fiscal policy by the Greek government.

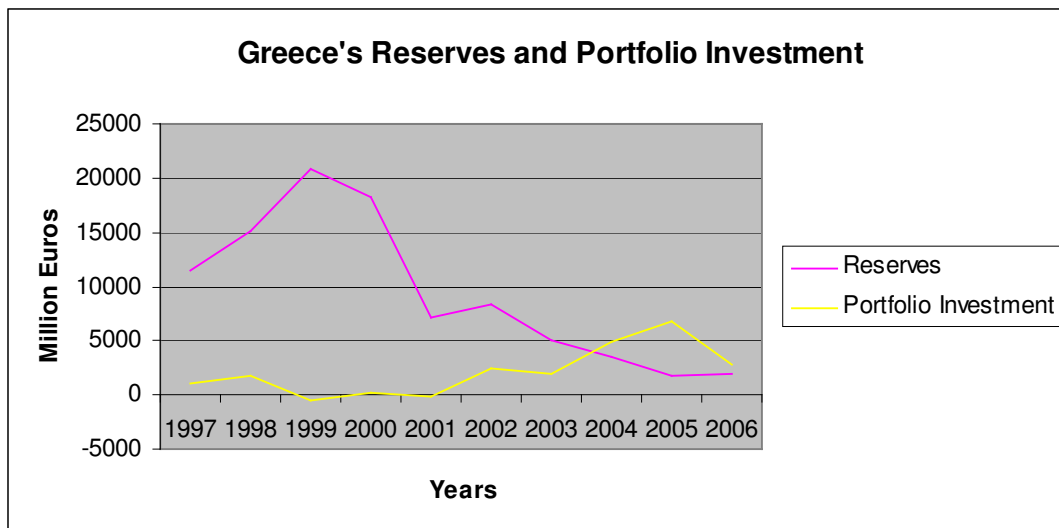
Since Greece fixed its currency to Euro, the exchange rate risk because of fluctuations and unexpected devaluations disappeared.

4. LESSONS FOR TURKEY

The first point that the Turkish decision makers should consider is choosing the right path leading to EMU by setting priorities. Greece's pre-EMU economic performance in a quite short period helped it to melt in the EMU pot. Different from Greece Turkey has a longer period ahead of it and this period can be used to make the necessary structural reforms and have better macroeconomic indicators by implementing monetary and fiscal policies with long term targets.

As Özatay (2005) indicates Turkey is currently in a process of transition from fiscal dominance period to monetary dominance period. This transition period will be causing problems related to the capital inflows and reverse dollarization, that is appreciation of the domestic currency.

Reverse dollarization has a major outcome that directly affects the trade balance of Turkey. Since Turkish Lira appreciates, goods exported will be relatively expensive in the international markets, which creates further trade deficit. Central Bank has the main tools to overcome this problem through reserve accumulation and thus intervening to create a controlled foreign exchange stability. As we see in Graph 3, Greece implemented a similar monetary policy throughout this transition process of EMU integration. It is obvious that foreign currency reserves of Greece increased. As Greece became a member of EMU, reserve control and the definition of reserves changed so it would not be rational to compare the values before and after the accession. Turkey, at the current time follows a similar path with foreign reserves of 52.9 billion US\$ for January 2006. In the Graph 2, it is seen that Central Bank reserves are in an increasing trend to stabilize the exchange rate.



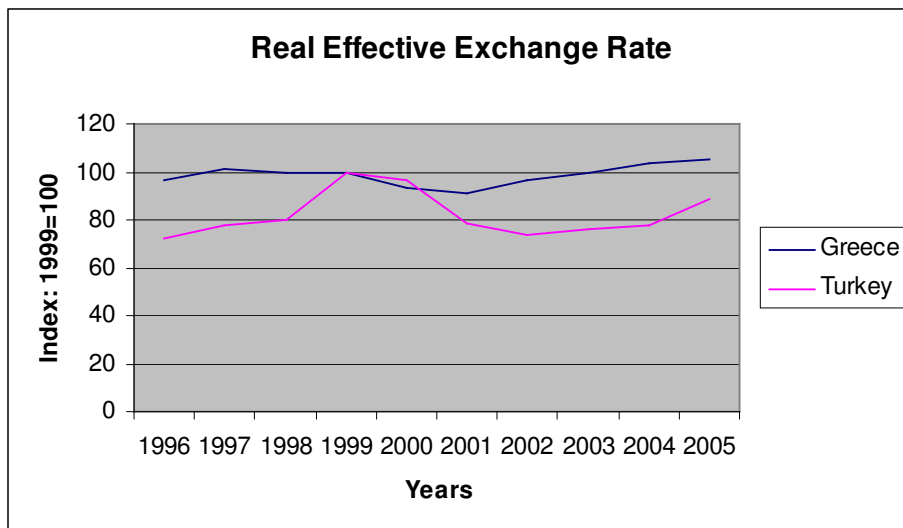
GRAPH 2*: Reserves and Portfolio Investment of Greece

Source: Bank of Greece

Second aspect of the transition period is the high amount of capital inflows. As in the case of 2001 crisis, the outflow of short term capital (-11.8 billion US \$) may have some undesired consequences, so a surge in capital inflows is not reliable for the sake of economic stability. Since capital inflows are at such a high level, it plays a great role in covering current account deficit. Government should try to promote foreign and domestic direct investment rather than being satisfied with the capital inflows. One of the ways towards that goal can be lowering interest rates or having some regulatory changes to make investment easier and less risky. Besides, diminishing inflation rates also contribute a lot to the portfolio investment decisions.

Graph 2 indicates that Greece succeeded to keep portfolio investment in a specific margin before accession to EMU. After being a part of EMU, benefiting from the optimistic environment and the assurance provided by EU portfolio investments follows an increasing trend.

One of the major points about the accession process to EMU is political support and consistency. Rather than applying populist fiscal policies, the Turkish government should focus on long-term targets.



GRAPH 3: Real Effective Exchange Rate

Source: Eurostat

After the accession to EMU, due to the increase in the credibility of the Turkish economy and financial agents with the help of the guarantee of the European Central Bank, Turkey can negotiate to revise its foreign debts.

5. CONCLUSION

This paper focuses on the process and impacts of successful Greek integration to EMU. Possible lessons are driven for Turkey, which will make the integration process lead to the desired results.

Greece managed to stabilize the prices and obtained an inflation rate below 2%. It also improved its problematic government finances and observed government deficit less than 3% of the GDP accompanied with a government debt less than 60% of the GDP. Also, the Greek economy reached 6.4% long term interest rates. All those indicators were below the reference values of the convergence criteria by 2001. In addition to that, exchange rate fluctuations were small enough to be a part of the European Monetary System without devaluation. The commission and the ECB also reported that the Greek Central Bank had a structure that was suitable to be embodied in the ESCB.

Notes:

* Data correspond to the following months of the given years;

1997 June-sept

1998 June-sept

1999 April

2000 April

2001 April

2002 April

2003 April

2004 April

2005 April

2006 January

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