Was Greece ready for the euro?

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During the recent debate in the Parliaments of many eurozone member-states regarding the approval of the new 130-billion-euro loan to Greece, some members of parliament questioned whether Greece had been ready to participate in the enterprise of the common currency, the euro, at the time of its entry.

In the mid-1990s, Greece made a formidable effort to meet the convergence criteria. It employed all available means: budgetary policy, monetary policy, income policy and extensive privatisation of banks and public enterprises. By any measure of fiscal performance (cash or national accounts), the government deficit fell by ten percentage points, from 12,5% of GDP in 1993 to 2.5 % in 1999, the year whose economic statistics were used by the European Council at Santa Maria da Feira in June 2000 to endorse Greece's eurozone participation. Greece's performance was also positive with regard to the other nominal convergence criteria (inflation rate, long term interest rates, public debt and exchange rate). It is worth recalling that the decision endorsing Greece's eurozone admission was made after exhaustive scrutiny of the Greek economy and respective reports by the European Commission, the European Central Bank and the Economic and Financial Committee. It is also worth noting that, in spite of the

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tight budgetary and monetary policies which were essential in order to reduce government deficit and inflation rates, GDP growth rates started to improve. From negative growth in 1993, it rose to 4% by the end of the 1990s and remained at that level until 2007. Private investment increased and foreign capital flowed into Greece due to the reduction of inflation and to the fall of interest rates to single digit figures after twenty years of double digits.

Those who claim that Greece should not have joined the euro area name three reasons. The first and most well known is that Greece supposedly falsified its economic statistics in order to gain EMU entry.

In 2004, four years after Greece's eurozone application had been endorsed on the basis of those statistics, the newly elected New Democracy government decided to change the method of recording defence equipment expenditure so as to lighten the budgetary burden during its term of office. This change meant recording expenditure, upon payment of the deposit, instead of recording it upon delivery, as had been done by the government until then. However, this change had the effect of increasing government deficits prior to 2004 and thus damaged Greece's reputation. The allegation that Greece had entered the eurozone by falsifying data made headlines in numerous newspapers around the world. Unfortunately, the assertion was also adopted by many politicians in the eurozone and is repeated to this day. But the allegation indicates ignorance, not to say hypocrisy. Because even including defence expenditure upon order and not delivery, under the new recording method the revised state deficit figures in the critical year (1999) became 3.1% of GDP against 2.5% of GDP previously. The precise figure was actually 3.07%, according to Eurostat (AMECO). This deficit is still lower than the equivalent revised deficits of other member states that were assessed on the basis of 1997 statistics and which formed the first wave of member states that created the euro area in 1999. The AMECO website shows that many other member-states entered the euro area with state deficits that were higher than 3.1% of GDP. But there is little public reference to this fact, ever thought many of these now manifest similar problems to Greece.

The responsibility for this certainly lies with the New Democracy government of Greece at that time. However, it also lies with Eurostat and the European Commission, which simply adopted the (revised) budgetary data issued by the Greek government of the day. They did not ask the Greek Central Bank, or the previous government, for their views. What happened later, in 2006, was in complete contrast: Eurostat decided that the correct method of recording defence equipment expenditure was upon on delivery of equipment, the very same method that Greece had used prior to 2004. Despite this decision, however, Eurostat did not retrospectively correct the figures: Greece's government deficit remained at 3.07% of GDP in 1999 when it should have been adjusted in line with the new decision. The insignificant divergence of 0.07% of GDP from the Treaty limit, which was adopted uncritically by the administration of the eurozone, thus became the reason to disparage a very formidable effort of economic adjustment. On this subject, we also note that an attempt has been made recently to defame Greece in connection with a conventional currency swap between the Greek Economy Ministry and Goldman Sachs at the end of 2001, one out of hundreds transacted at that time by all member states in straightforward acts of public debt management. Once again, it was said that Greece had cooked its books so as to enter the euro area: again this became a headline and was adopted by many politicians. Yet the fact that the swap took place two entire years after 1999, the year on whose economic data Greece's entry to the euro zone was decided, and one entire year after the European Council of Santa Maria da Feira endorsed Greece's entry appears to have been forgotten.

The second reason cited to support the claim that Greece's entry to EMU was a mistake is that of government extravagance and excessive deficits.

Economic performance in Greece after 2003, especially during the second half of the decade, unfortunately did not keep pace with that of the eight preceding years. In 2006, the government of the day began to lose control of state expenditure and revenue, a process that culminated in 2008 and 2009 when the government deficit shot up to more than 10% of GDP. The collapse of Lehman Brothers and the markets' reassessment of financial risks led to an increase in government bond spreads in Greece, the weak link in the eurozone. This sparked the Greek public debt crisis. The failure of two successive Greek governments to act promptly to implement strict stabilization measures and the euro area's hesitation in intervening, led Greece outside the financial markets and to its rescue, after much hesitation, by the Troika (IMF, EU, ECB), on condition that strict measures be implemented to restore budgetary balance and competitiveness.

Was extravagance the sole cause of this outcome? The principal causes of the crisis in both Greece and other member-states on the eurozone's periphery were their large and increasing current account deficits, their loss of competitiveness and, more crucially, the different levels of development of the North and the South, rather than the administrative incompetence of their leaders. The South buys high-quality, high-tech industrial products from the North. The North, by contrast, buys far fewer goods from the South. From 2000 to 2007, the average current account deficit of Greece was 8.4% of GDP and that of Portugal 9.4 %, while Germany had a surplus of 3.2 % of GDP and Netherlands 5.4%. In order to finance their increasing current account deficits, countries on the periphery had to borrow more and more, thus becoming further indebted.

The tardy operation of public administration and institutions also gave rise to the claim that Greece, and possibly other member-states on the periphery, should not have joined EMU. But EMU is not a club of advanced countries whose common interests are opposed to those of the countries that lag behind. It is a stage of development in the Union whose purpose is to facilitate economic co-operation among its members, to create relationships that strengthen the common endeavour to grow, to achieve gradual convergence of their economies and to better exploit the opportunities presented by shared objectives and the abolition of borders. Since it is a joint plan for progress, its design should include both the powerful with their strengths and the less powerful with their weaknesses. It must take into account the inequalities and the fact that the developed countries not only bear burdens but also obtain significant benefits, thanks to their financial services and exports.

The implementation of the stabilization measures in Greece since May 2010 has brought about significant improvement in fiscal performance and competitiveness, but it has also contributed to the deep and lasting economic recession, the sharp rise in unemployment to 20%, and the impoverishment and destitution of part of the Greek population. Greece is not solely responsible for this outcome. Since the economic policy mix imposed by the first loan agreement was not the most appropriate, the performance expected was unrealistic even for countries with far stronger economies than that of Greece. There is a widespread feeling that the conditions imposed were intended to teach other countries a lesson by punishing Greece. The recession, initially predicted by the IMF to be -7.5% for the four-year period 2009-2012, is now estimated to have reached -18%, resulting in a failure to meet other targets and generating intense social unrest.

Greece was the occasion of the euro area crisis but not its cause. The cause lies in the fact that the euro area is a fully-fledged monetary union but an incomplete economic and fiscal union of member states with different structural features: the more mature economies of the European North with the less mature economies of the European South. The present crisis is only to a small extent a public debt crisis, and that mainly concerns Greece and Portugal. Other than that, it is a crisis of the private sector and the banking system in several member states as well as a crisis of control and supervision by the financial and monetary authorities of the euro area. The European Union has not yet created an overall framework of economic governance, a new method of dealing with the inequalities between its developed core and its less developed periphery. It has not worked systematically to truly promote economic growth. If this is not done, there will be more crises in the future. The fiscal compact which, according to euro area leaders, will ensure the stability of their economies, cannot achieve that result without additional measures for growth and real convergence and, in the end, without sufficient progress towards economic integration and political union.