From accession to the European Communities to EMU membership:
The long convergence of the Greek economy (1981-2001)

Isaac Sabethai
Director of Economic Research Department
Bank of Greece

Greece's relationship to what is now called the European Union is long-standing. An "Association Agreement" with the European Economic Community had already been signed in 1961, but was virtually suspended during the seven-year military dictatorship (1967-1974). Following the re-establishment of democracy in 1974, Greece applied for full membership in the European Communities. Both the government and a strong majority of the citizens hoped that participation in a larger European family of democratic and economically developed nations would eventually lead to economic prosperity and – perhaps more importantly -- would also strengthen the democratic regime, foster political stability and guarantee peace with Greece's neighbours. The long and arduous negotiations that followed led to the Treaty of Accession, which was signed in May 1979, and Greece joined the European Communities in January 1981. The Treaty provided for a transitional period of five years for many issues, seven years for the free movement of workers and two years for certain items of the *acquis communautaire* related to social policy. (An examination of the debate leading to this negotiated outcome, e.g. concerning the free movement of labour, may be instructive for today's candidate countries.)

The years of preparation for accession (1974-1980) and the first thirteen years of EC membership (1981-1993) were a period of slow but continuous maturation of Greek society, economy and institutions. Greece had lagged behind Western European countries during the "interval" of the military dictatorship; it was now trying to catch up in terms of democratic practices and living standards. Economic agents had to learn to operate responsibly in a free and competitive society, i.e. they had to become "social partners" and to stop expecting the state to act both as a "provider" of first *and* last resort and as a policeman (and/or mediator). On their part, governments had to accept that a share of power had to be ceded to civil society. Governments also had to learn to avoid the temptation of using fiscal policy (and economic and social policy in general) for short-term electoral gains and at the detriment of future generations. At the same time, the Greek economy was feeling the impact of the lifting of trade barriers, of the inflow of Community funds (both for the support of agricultural incomes and for structural intervention), and of the institutional "boost" from the transposition of the *acquis communautaire* and the implementation of policy guidelines formulated at the Community level. The end result of these various factors was a slow process of modernisation, marked by ups and downs in GDP, inflation (which was high or less high, but never low!) and real incomes and by slowly rising unemployment. It is revealing that restrictive policies and/or stabilisation programs implemented in 1979-81, 1983, 1985-87 and 1991-93 did not yield permanent gains, although they *did* avert a further worsening of the economic situation.

Things started to change since the early 1990s and more clearly so since 1994, when the new "1994-1999 Convergence Program of the Greek Economy" was adopted, marking a qualitative shift in the economic policy mix. There was now more effective coordination of monetary, fiscal, incomes and structural policies towards the attainment of low inflation, of low government deficit and debt compared to GDP, and of exchange rate stability. The *steady* improvement in the economic situation meant that sacrifices were not wasted anymore; moreover, since the improvement was *visible*, it helped to increase the credibility of the policies followed and made it easier for social partners to adopt a moderate stance with regard to wages and prices. The Program relied on a *balanced* set of policy guidelines and thus managed to generate a "virtuous circle" of lower inflation-lower interest rates-lower government deficits-lower inflation. Further, inflows from the EU's Structural Funds and falling interest payments on the public debt allowed government investment to rise fast. Business investment also rose at record rates, precisely because of increased confidence in economic policy (which in turn led to positive expectations) and because firms wanted to prepare for tougher competition once "inside" the EMU. The structural reforms that were undertaken in this period (the liberalisation of the banking system, the partial privatisation of public enterprises, the independence of the Bank of Greece, the introduction of free collective bargaining and of greater labour market flexibility – just to cite a few examples) also helped. Thus, by mid-2000, Greece had fulfilled all the *nominal* convergence criteria of the Maastricht Treaty and as of January 2001 Greece has become a full member of the euro area. Further, Greece has been on the path of *real* convergence for the last six years (1996-2001), during which Greek GDP has been rising faster than the GDP in the EU or in the euro area.