The Greek Political Economy

2000-2015

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(Eds.)

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Foreword

This collective volume systematically documents the course of Greek political economy from 2000 to 2015. The editors of this volume had two reasons for taking on this initiative.

The first is the scientific interest the Greek economy shows as a part of international and European political economy. Recent developments in both the global and European economic environment, along with Greece's role in how these developments came about, compelled the contributors to this volume to identify the key determinants of the Greek economic crisis and ways in which the Greek economy fuelled both the European and global financial crisis.

The second reason is the need to understand why Greece found itself in such a grave economic predicament and to seek ways of exiting a situation that has undermined the country's place in the global economic system. Undoubtedly, only by understanding the erroneous policies pursued by Greece, will economists, as well as decision-makers, be able to formulate strategies that will maximise national interest in the years to come. The Greek economic crisis is unique for several reasons:

a) The global financial crisis of 2007 is the largest in history (Krugman, 2009, p. 199).
b) It occurred at a time when Greece's membership of the European Union's Economic and Monetary Union, deprived it of the ability to run its own monetary policy.
c) The international economic environment is much more interdependent than ever.
d) In the postwar era, the global economy has undergone colossal changes, such as the emergence of rapidly growing economies, which create conditions for economic competition among countries, whose manifestations include the pursuit of protectionist policies with unforeseeable effects.

Obviously, the success of this project requires a multidisciplinary approach. The combination of diverse disciplines, such as political economy, international economic relations, European political economy and international political economy, is indispensable to understanding the complex contemporary structures of the global economy.

The key contribution of political economy is the admission that economics is a highly restrictive social science, since it tries to understand modern economy within a strictly mathematised framework. The mechanistic approach to the workings of the economy had its limitations. As stated by Professor Georgios Hadjiconstantinou (1998, p. 45-46):

> Adam Smith's "invisible hand", the mechanism of supply and demand, the mechanism of prices, the determinative content of the «law of markets» (*loi des débouchés*) of J.B. Say, the market mechanism, the mechanism of money supply and demand, the interest rate mechanism, the stock market mechanism, and, of course, the General Equilibrium that ultimately prevails in theory, provide a first clear view of Newtonian and Copernican influence on the formation of economic theory, interpretation and reasoning. Mechanisms and laws everywhere; predetermination and causal relationships on all levels; linear conception of developments, hardly concerned with structural differentiation, and focusing instead on quantitative growth and conjuncture (*conjuncture*). Finally, abstraction and assumptions that merely touch on reality, ranging from the adoption of an instrumentalist (*instrumentaliste*) or positivist (*positiviste*) methodological doctrine to the promotion of the imaginary and abstract concept of the *homo oeconomicus*, which is a far cry from the multidimensional reality of the *homo universalis*.

This analysis shows that, in such an increasingly complex international economic environment, the mechanistic approach to understanding the global economy is overly restrictive. The global financial crisis undermined the belief that the adoption of abstract theoretical approaches provides the appropriate interpretative framework for understanding modern global economy. Nonetheless, it will take time and scientific persistence until contesting the dominant approach creates the conditions for the emergence of a new interpretative framework based on the principle of multidisciplinarity, with the aim of offering a comprehensive understanding of the workings of the global economy.

The greatest weakness of economic science lies in its predictive power (Kotios & Galanos, 2010). Any attempt to predict economic developments is of limited practical use in today's economic and political environment. After all, the global financial crisis of 2007 highlighted the complexity of the determinants of the crisis and their strong feedback relationships; as a result any attempt at mathematisation seems removed from the actual operation of the international economy.

Economic science's inability to predict the complex effects of the global financial crisis leads economic theory to a quest for new interpretative outlets, since it has not yet managed to incorporate the economic policy through which global economic institutions operate (Tsoulfidis, 2011).

International political economy, a modern field of study that emerged only in the early 1970s, acknowledges that the global economy can be understood as the sum of its defining parts (O'Brien & Williams, 2011). These defining parts may be either economic or political, and may originate in either the domestic or the international environment. Understanding the modern world under the lens of these four dimensions raises international political economy to the status of a state-of-the-art holistic approach, which acknowledges that multidisciplinarity is the means for understanding an increasingly complex modern world (Sklias, Roukanas & Maris, 2012).

Let's see what Professor Panagiotis Ifestos (2010) has to say on the subject of international political economy:

> Irrespective of the extent to which international political economy selectively reaches out to other areas of social science, its core ingredients, or to be more precise, the two sides of the same coin, remain unchanged. These are: first, economic science, which ranges from micro- and macroeconomics to international trade and any other international economic activity; and second, the political science of international relations, in other words international studies in their holistic form, which are fostered by political realism. Only such a multifaceted and holistic view can render them professionally useful and socially-practically beneficial.

In conclusion, the study of the Greek economy, from the country's accession to the EMU until 2015, requires a synthesis of diverse disciplines that interpret the Greek economy's interaction with the global and European economy within a complex socio-political framework. This serves both the key objective of science (i.e. to seek the truth), and the objective of this collective volume (to seek the causes that brought the Greek economy to its current situation).

The purpose of this theoretical discussion was to present the analytical framework for understanding this collective effort. In 2000-2015, the Greek economy grew within a wider international economic and political framework, which determined the structure of the global economy.

The course of the Greek economy in the past few years has been at the epicentre of international debate, as part of the fallout from the global financial crisis. The Greek economy's present position within the global economy is the result of a series of economic policy choices made by the Greek government, as well as various economic developments that distorted the growth of the global economy, culminating in the outbreak of the global financial crisis in August 2007. This collaborative effort highlights the factors and economic policies that made it necessary for Greece to resort to the Tripartite Support Mechanism and remain under its supervision until 2015. The evolution of Greek political economy, from Greece's accession to the Economic and Monetary Union until 2015, is thoroughly analysed and recorded. Although identifying the causes of the Greek economic crisis has been the object of intense economic and political debate, there has been no systematic, holistic, and scientifically documented study of the origins of the crisis. The purpose of this collective effort is to shed light on all the factors that led the Greek economy to the brink of collapse.

Under this lens, and without any ideological, political and scientific biases, we try to answer the crucial questions surrounding the Greek economic crisis. The essays comprising this volume call attention to the main factors that shaped Greek political economy. This study begins with Greece's accession to the Economic and Monetary Union, since it led to the country's integration in the structures of the

European Union. Each chapter analyses the risks, opportunities and errors in the period following Greece's accession to the EMU and within in a fiercely competitive environment.

This book is divided into four parts. The first part discusses the conditions prevailing in the Greek economy both before and after the country's accession to the EMU.

Pantelis G. Sklias and **Georgios Maris** offer an historical review of the 1980s and the 1990s, in order to help readers understand the context of the events that led to the signing of the Maastricht Treaty and more specifically, the Delors Report. Then they examine the Maastricht Treaty and the convergence criteria set for attaining EMU membership. Finally, they look into Greece's public finances from the early 1980s to the early 1990s. The convergence criteria, apart from lacking any solid theoretical basis, were the result of a compromise, following a period of tough negotiations for the creation of the EMU. The Maastricht convergence criteria reflect the economic and political interests of the most powerful member states of the EU, and in particular those of Germany and France. At the same time, Greece's case offers a typical example of a country's refusal to adapt to global and European economic developments. This "tacit" refusal, evident in the economic policy decisions taken during that first phase, would in the long term jeopardise the very future of the country.

Pyrros Papadimitriou illustrates how the way in which the government of the day handled the EMU accession effort affected the real economy, and demonstrates the need for a different economic policy in the early post-accession period. Greece finally managed to join the EMU, but the way this was achieved, combined with the fact that, following accession, the government did not implement the reform programme it had put forward at the 2000 election, was instrumental in shaping future developments. The first part of the essay is a presentation of the economic situation in Greece and Europe from 1992 to 1999. It is followed by a discussion on how Greece managed to reduce inflation and fulfil the fiscal criteria. Finally, the essay summarises the main consequences of the way Greece joined the EMU, an entry that left very little room for economic policymaking.

Evaggelos Drimpetas and **Nikolaos K. Kalogeridis** explore the technical and structural aspects of the banking sector's dynamics, trying to identify some of the causes of the present multidimensional crisis. In 2013, Greek banks, caught in the maelstrom of one of the worst crises in their history, were recapitalised *en masse* by the Greek state in order to ensure their survival. The essay analyses phenomena such as the sector's over-expansion and concentration, in conjunction with key qualitative features, such as capital adequacy and bad debt ratios. A guiding premise is that today's problems are not exogenous phenomena, generated by the deep crisis of the Greek economy, but their roots need to be traced back to the development of the banks themselves during the period under review, which, of course, is closely correlated with, shaping and being shaped by the course of the entire Greek economy. Understanding changes in the banking system during the period under review also requires a brief outline of the situation prior to 2000. Consequently, the authors' analysis includes a look at the years 1990-2000 and at the basic regulatory regime that determined the fate of the banking system.

Constantinos P. Tsamadias presents the evolution of the Greek economy's growth rate, fiscal deficit and public debt during the post-transition period. The essay studies Greece's annual fiscal results, as well as the public debt, which accumulated rapidly during the post-transition-to-democracy period that followed the seven-year dictatorship. The fastest growth rates were recorded in the 1980s. Public debt exceeded 60% of GDP in the second half of the 1980s and 100% of GDP in the early 1990s. Since the late 1980s, public spending for sovereign debt amortisation and interest payments had been high and growing. In terms of comparison, during the global financial crisis (2007-2009) there was no fiscal derailment in Greece, since the starting base was already high. There was no discipline in the execution of state budgets. Covering fiscal deficits and refinancing the debt were ensured through low-cost state borrowing until the end of 2009. Borrowing costs spiked since the beginning of 2010. In spring 2010, the country resorted to the Support Mechanism. A violent fiscal adjustment programme was implemented, with painful consequences for both households and enterprises. In late 2008, the economy entered a recession, which deepened in 2009, 2010, 2011, and 2012, and persists today. Although there has been some fiscal stabilisation since 2013, as the twin deficits have been reduced, Greece is still floundering. It is imperative to form and implement a national plan, which transcends our partners' violent adjustment programme and aims at the country's reconstruction.

Emmanuel C. Mamatzakis analyses Greek statistics and how they contributed to the current economic crisis. Greek statistical data, and especially the problems recorded during their periodic announcement to the EU over the years, demonstrate a lack of long-term fiscal adjustment that would render the debt sustainable. As a member state of the EU and the euro zone, Greece is required to submit precise fiscal data twice a year. Today, of course, supervision is permanent and the same applies to the announcement of data, intensifying the pressures for properly recording the fiscal situation. However, accurately recording fiscal aggregates has never been easy. A review of the disputes and revisions of Greek fiscal data, demonstrates the gravity and complexity of the problem. The causes of these disputes and revisions are manifold. Identifying all the causes requires methodical and arduous work, in order to unravel Ariadne's thread. This essay is an effort to examine the most important issues in regard to the Greek statistical data of the past two decades. Obviously, Greece, like other member states of the euro zone, has always had statistical problems. The difference is that in Greece's case the revisions were much larger. The analysis demonstrates that the solution of the problem is definitely intertwined with the fiscal sustainability of the Greek economy.

Part two discusses the fiscal situation of the Greek economy from 2004 to 2009.

George Galanos explores the following questions: What was the Greek economy's fiscal position over time? What were the results of Greece EMU membership to date? Why did the fiscal crisis lead the country to recession and brought it to the brink of fiscal collapse? In the past few years, Greek citizens have been experiencing economic and fiscal crises. On the economic policy level, there is a clear strategic orientation towards reducing government debt as a percentage of GDP. Following Greece's subjection to the Support Mechanism, all economic and other policies centred on solving the country's fiscal problem. That said, the study of Greece's fiscal position over time will show that countries with traditionally "strong" economies, such as Canada, Japan, Italy, even the United Kingdom, have major fiscal problems of their own. In fact, in the euro zone, the fiscal situation of most states is the worst it has been in fifty years; even countries such as Germany, France, and the Netherlands, which many analysts considered to be leaders within the Economic and Monetary Union, seem to be in good fiscal-financial condition only when compared to the desperate situation in other countries. This is not true, however, if one takes into account the absolute figures, which show that these countries maintain high public debt ratios.

John C. Mourmouris, more than ten years after the 2004 Olympics Games in Athens,offers a scientifically documented answer to two crucial questions concerning the impact of the Olympic Games on the Greek economy and the cost of the Olympic Games. As part of his effort, he examines all of the available national accounting data, records and sources, identifying and quantifying both the direct and indirect effects of the Games. The assumption that the Olympic Games would have a major positive impact on Greece's growth was the main political argument for the approval and realisation of the project. Greece's economic fundamentals were the weakest among all the countries that hosted the Olympics since 1945 and any adverse impact was also equally likely, in a country that, after becoming a full member of the European Union membership and faced with the prospect of its EMU accession, was looking for a new national vision. International perception of the impact of the Olympic Games on host-country economies and host cities is that, despite any promised positive outcomes, in Montreal, Seoul, Sydney and Athens they usually end up as economically undesirable. The scientific analysis of this crucial issue almost always lacks well-documented and comprehensive studies of the economic situation before and after the Games, as well as of the causal relationship between Olympic Games-related investment activity and growth. Scientific analysis is further impeded by the speculation over the other investments that could have been made instead of in the Olympic Games, and their effect on growth. In Greece, the key question is still whether, and to what extent, the Olympic Games precipitated or contributed to, the country's descent into the economic abyss, a descent that is also threatening Europe and the euro. The amounts that Greece allegedly spent range from 7 to 13 billion euros, but these estimates lack any scientific documentation and, more often than not, are dictated by political expediency.

Aristidis P. Bitzenis and **Ioannis Makedos** examine how the "fiscal inventory" exercise affected Greece's fiscal credibility. They pay special attention to the development of Greece's public finances in the wake of the 2004 Olympics. Then, they discuss the inventory's effect on public finances, as well as Eurostat's revisions. They also examine the causes of Greece's economic plight and the ensuing political mistakes. They also discuss the role of ELSTAT in inflating the fiscal deficit and the public debt; the recapitalisation of Greek banks and its outcome; the role of "creative accounting"; and, finally, the incorporation of the shadow economy into the Gross Domestic Product (GDP) with the aim of improving the public debt-to-GDP ratio, as well as Greece's fiscal deficit to GDP ratio.

Maria F. Tsampra and **Giota St. Chatzimichailidou** examine the growth of employment in the Greek public sector as a key parameter of the intense debate on the "hypertrophy" of Greece's government sector, as well as on its corollaries, such as the burden on the national budget and the disproportionately limited operational, functional and economic efficiency of public services. The scope of their study covers the administrative services of the government sector in the narrow sense (e.g., ministries), as well as all utilities and services (e.g., healthcare, education, energy, water supply, transportation) of the wider public sector. The study focuses on the period from EMU accession to the time of writing, although the analysis often goes back to previous periods of Greek public sector growth, in order to explain its evolution to date. The outbreak of the global financial crisis and the proceedings that were set into motion in 2009, leading the country to the Tripartite Support Mechanism, render this discussion highly topical, given that the institutional and operational restructuring —or, as many would say, dismantling— of the public sector has already began.

Moise G. Sidiropoulos examines the role of economic policy in the years 2004-2009 in Greece's economic growth. To this end, he discusses the role of the euro as a growth tool for the Greek economy. Moreover, he assesses the effects of the Economic and Monetary Union, as well as the role of the economic policy pursued in regard to economic growth during 2004-2009. Finally, he examines the options of the Greek economy in the context of the current economic crisis.

That said, any study of the Greek economic crisis would be incomplete without an assessment of the global economic crisis and its effects on the European economy. After all, the global economic crisis fuelled the European economic crisis, which manifested itself in two forms: either as a banking crisis, or as a debt crisis, the most typical case being that of Greece. Under this lens, part three of this volume discusses the effects of the global economic crisis on both Europe and Greece. The global economic crisis was a turning point for the Greek economy, as it cast into relief a structural fiscal problem: Greece's high public debt.

Periklis Gogas and **Elvira Takli** study the framework of the global economic crisis. The starting point of the global economic crisis was the collapse of the subprime mortgage loan market in the United States. This crisis is considered to have begun with the credit crunch in July 2007, when US investors lost their faith in the value of subprime loans, initially causing a liquidity crisis in the banking market, which prompted the US Federal Reserve to pump liquidity into financial markets. By September 2008 the crisis had escalated, as financial markets all over the world either became highly unstable or collapsed. As a result, consumer confidence plummeted, out of fear of what could possibly follow. Subsequently, issues such as the high public debt of the US and the rise in oil prices exacerbated the situation of the American economy. Finally, leverage and securitisation helped the crisis take on global dimensions, also owing to the regulators' failure to control financial transactions and contain risk in international markets.

Konstantinos J. Hazakis analyses the economic governance crisis in the euro zone and its implications for the management of Greece's public debt. He succinctly evaluates European Economic Governance (EEG) activity in handling the Greek debt crisis from October 2009 to November 2013, using institutional economics.

Amélie Barbier-Gauchard studies the impact of the global economic crisis on economic governance in the EU. The unprecedented financial crisis that began in 2008 sheds light on the significant gaps in EMU architecture. Excessive risk-accumulation in quiet/good times in both the public and private sectors underline the need to improve risk prevention. The risks of financial instability within the single currency (failing market discipline, insufficient monitoring and enforcement tools, contagion between fragile sovereigns, feedback loops between weak fiscal and banks, financial fragmentation across the euro area, even threatening the integrity of the euro area) underline the need to improve crisis resolution. As a consequence, several changes occurred since 2009 to correct the shortcomings in EMU governance. This contribution explains these key developments, with particular attention to the major changes between the situation before and after the economic crisis, especially for the member states of the EMU.

Lothar Funk analyses the effects of the global economic crisis on Germany. He studies how Germany coped with the crisis in its banking sector, the labour market, and with respect to its sovereign debt. Particularly well-known and simultaneously controversial is Germany's ongoing trade surplus. Also hotly debated is its role during the crisis in the euro zone. The essay argues, however, that Germany has never sought dominance but rather defended –probably not more than other states– only its vital longer-term national interests, and has to deal with huge challenges now and in the future.

Emilio Colombo studies the impact of the international crisis on the Italian economy. He argues that blaming the economic crisis for Italy's economic crisis is a simplistic and partial explanation. In fact the major causes are deeply rooted and are attributable to structural deficiencies and lack of reforms that considerably weakened the Italian economy from the adoption of the single currency to the eve of the crisis. When the crisis hit, the problems came to light and the effects proved unexpectedly severe and persistent.

Part four analyses key fiscal aggregates and how they affected Greece's entry into the Tripartite Support Mechanism.

Panagiotis Liargovas and **Spyridon D. Repousis** discuss how the combination of high fiscal deficits with easy and cheap credit boosted domestic consumption, leading to economic growth and an increase in GDP, which were, nonetheless, not sound and sustainable in the long term, resulting in a ballooning debt. Thirteen years after Greece's accession to the Economic and Monetary Union, it is evident that the entire venture failed in many ways, since Greece joined hastily, unprepared, and without the infrastructure required at adjust to the new economic reality. The opportunities offered by low borrowing rates and EU financing were not fully utilised for securing sustainable growth, while the drop in national savings rates, combined with inflation rates higher than those of other European countries, the loss of competitiveness, and spiralling fiscal deficits revealed the Greek economy's structural vulnerability to all forms of economic crisis.

Angelos Kotios and **Emmanouil Koutoulakis** discuss and evaluate the interaction between Greek, and to a certain extent European, economic policy and financial markets, during the crucial months from October 2009 to May 2010, which left its mark on the country's future. The key questions are as follows:

- What were the country's fiscal situation and creditworthiness at the onset of the crisis?
- Under what terms was the country borrowing before the markets woke up?
- Which factors contributed to the markets' awakening and the reversal of their stance?
- What was the response of the national economic policy and the euro zone's governance system to the oncoming avalanche?
- Which factors contributed to the vicious circle of rising spreads and Greek Government borrowing rates?
- Were recourse to official lenders and the exclusion from the markets inescapable, or was there an escape route?

Panagiotis Schizas examines the economic crisis in Greece and the concerns over the effect of Credit Default Swaps (CDSs) and similar assets, on the public debt crisis.

Spyros A. Roukanas studies the Dual Fiscal Crisis analytical framework and its application in the case of Greece. This is the first effort to outline the Dual Fiscal Crisis analytical framework, which identifies both the key factors that lead to the emergence of fiscal crisis, and their interdependence. It is also an effort to identify the main factors that undermined Greece's negotiating power and led to its entry into the Tripartite Support Mechanism. Identifying the failures and oversights of the economic policy of that period will also shed light on alternative approaches, which could have established a different economic policy mix that was less detrimental for Greece's public finances.

Pantelis G. Sklias and **Georgios Maris** pinpoint the elements of Greek government's policies of that period that led to the Memorandum. They specifically evaluate Greece's road to the Memorandum, the proposals it presented and the alternatives it had, and then discuss the most important elements of the first Memorandum. The first period of governance, from October 2009 to the signing of the first Memorandum, was marked by a complete lack of negotiation. The Greek government did not formulate any feasible plan for exiting the crisis. Greece was shut out of the markets, mistrust in its economic situation spread all over the world, and the Memorandum was inevitable.

Spyros A. Roukanas studies the political economy of the Greek crisis from May 2010, when Greece joined the Tripartite Support Mechanism, to 2015. First, the essay evaluates the Support Mechanism. Any evaluation of the Impact of the Tripartite Support Mechanism requires a synthetic approach. This is the reason for studying institutional and macroeconomic impact of the crisis on the Greek economy. As a whole, the fiscal adjustment policy imposed by the Support Mechanism had a negative institutional and macroeconomic impact.

We hope that that this collective volume will offer a more comprehensive understanding of the factors that led the Greek economy to present crisis, and possibly encourage further scientific research on the topic that avoids piecemeal statements or approaches.

Athens, March 2016
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PART I
GREECE'S ENTRY INTO THE EMU

Chapter 1

The Maastricht Convergence Criteria and Greece in the 1980s and the 1990s

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1. Introduction

As early as the late 1970s, European economic integration acquired a new dynamic, culminating in the signing of the Maastricht Treaty in 1992. The treaty, apart from the entry stages, laid out a series of "convergence" criteria that had to be met for a country to become a member of the EMU. That said, did these convergence criteria actually constitute necessary and sufficient conditions for the creation of a sustainable EMU? Why were these specific criteria selected? Was there a more appropriate theoretical basis for the establishment of the EMU? Apparently, the convergence criteria that were selected did not guarantee the EMU's long-term sustainability, making many authors severely critical of the effectiveness of the entire project. As long as fiscal policy remained a prerogative of the member states, and the architecture of the EMU did not ensure compliance with the convergence criteria, the member states would keep on breaking the rules. In this context, the case of Greece since the early 1980s is the most typical.

In the first part of this essay, we will discuss the key developments that led to the signing of the Maastricht Treaty. In the second part, we will examine the Maastricht Treaty and the convergence criteria set for attaining EMU membership. Finally, in part three of this essay we will look into Greece's public finances from the early 1980s to the early 1990s. We will demonstrate that, in addition to their feeble theoretical basis, EMU convergence criteria were a compromise among the interests of the EU's strongest member states, especially Germany and France (Maris and Sklias, 2015). Greece is typical of a country's refusal to adapt to global and European economic developments. This tacit refusal, evident in the economic policy decisions taken in that first phase, would, in the long term, jeopardize the future of the country.

2. The road to Maastricht

Following the success of the Single European Market, in the late 1980s all of the signs indicated that the time was ripe for establishing the EMU. Tomaso Padoa-Schioppa's (1987) report on the consequences of the common market on the European economy, presented a convincing link between the common market and the creation of the EMU. This link was self-evident after the speculative attacks against the EMS, which left no doubt among EU member states that the creation of the EMU had become a necessity (De Grauwe, 2003). In any other case, the member states should revert to a system of floating exchange rates. Thus, in 1988, Germany's Foreign Minister Hans-Dietrich Genscher produced a memorandum titled *A European Currency Area and a European Central Bank*, in which he stressed that Europe's monetary union was absolutely necessary for the completion of the common market. It was also necessary to create an expert group, to enable member states to formulate a series of proposals for the creation of the EMU (Mayer, 2012).

This is why the European Council meeting in Hanover, Germany (June 27-28, 1988) asked Jacques Delors to prepare a study on the creation of the EMU. That is how the Committee for the Study of Economic and Monetary Union was set up. This committee comprised the central bank governors of all twelve member states, a commissioner, and three independent technocrats, and was chaired by the President of the Commission, Jacques Delors. The purpose of the committee was to explore the conditions that could lead to the establishment of the EMU. The findings of the committee's report, the Delors Report, were published in April 1989 and stipulated the conditions and criteria for creating the EMU. According to the Delors Report (Committee for the Study of Economic and Monetary Union, 1989, pp. 14-15), a monetary union provided:

> [...] the assurance of total and irreversible convertibility of currencies; the complete liberalization of capital transactions and full integration of banking and other financial markets; and the elimination of margins of fluctuation and the irrevocable locking of exchange rate parities.

The Delors Report was the European Commission's first meaningful attempt to promote and secure the EMU. Jacques Delors had already acquired considerable experience in the field of monetary policy and was "ideologically committed to the goal of monetary union" (Hix, 2005, p. 257). However, the creation of the EMU, like that of the EU, could not happen overnight. The Delors Report, like the Werner Report, proposed three stages in the establishment of the EMU, albeit without setting any fixed deadlines, since the *ex-ante* determination of the member state economies' potential convergence was not possible.

The first stage provided for the completion of the internal market, the inclusion of all member states in the currency mechanism of the EMS, and the improvement of macroeconomic cooperation among member states. Moreover, it was decided to enhance the coordination of the member states' economic policies, as well as multilateral supervision. In effect, this stage would involve "the elimination of all restrictions on within-European capital movements, as well as the creation of greater separation between central banks and governments" (Dominguez, 2006, p. 70). The second stage would bring the institutional enhancement of the EMU, with the aim of further promoting coordination of member states' monetary policies. The third stage would result in the formulation of a common economic (monetary) policy, as exchange rates would be permanently fixed by irrevocably tying together the participating currencies, and the single currency would be created, even if this was not explicitly stated. The European System of Central Banks (ESCB) would also become operational, with any implications this might have for monetary and fiscal policy.

The Delors Report pointed out that, on the road to the EMU, the member states should fulfil certain conditions, such as the full convertibility of currencies, the stabilisation of exchange rates at certain levels, and the liberalisation of capital movements. It also proposed the establishment of the ESCB, which would be independent from any government intervention or control and, in addition, would impose ceilings on the member states' fiscal deficits. Furthermore, the Delors Report provided for the coordination of macroeconomic policies, as, despite not pointing out the necessity of a common economic policy, it demonstrated that the successful operation of the EMU would require the central supervision of the member states' fiscal policies (Dinan, 2005). More specifically, the Delors Report (Committee for the Study of Economic and Monetary Union, 1989, p. 11) stated that: "The success of the internal market programme hinges to a decisive extent on a much closer coordination of national economic policies."

In other words, the report was a plan that was adapted to the needs of that time, and did not envisage any transfer of sovereignty or a common EU budget (Verdun, 2007). Furthermore, it made no explicit reference to the Optimum Currency Area (OCA) theory as one of the major tools for evaluating the monetary union project, even though it did recognize "the problem posed by asymmetric shocks" (Wyplosz, 2006). As was made evident later on, OCA criteria never became a part of the Maastricht Treaty (Bini-Smaghi et al., 1993). In other words, the report confirmed the dominant states' coincidence of opinion in regard to the policy that should be pursued on the road to monetary union, which included the member states' commitment to monetarist orthodoxy. The EMU would be based on four principles: 1) price stability; 2) fiscal discipline; 3) austerity; and 4) structural reform.

3. Maastricht Treaty and convergence criteria

Based on the estimates of the European Commission, the EMU was a corollary of the common market. As discussed in a Commission report on the EMU (European Commission, 1990, p. 11):

> A single currency is the natural complement of a single market. The full potential of the latter will not be achieved without the former. Going further, there is a need for economic and monetary union in part to consolidate the potential gains from completing the internal market, without which there would be risks of weakening the present momentum of the 1992 process.

Under these circumstances, as argued by Wyplosz (2006), the divergence of opinion between France and Germany became apparent during the negotiations that led to the signing of the Maastricht Treaty. On one hand, Germany emphasized on economic policies and convergence; on the other hand, France focused on the creation of new institutional tools.

Following the Madrid European Council of June 1989, which adopted the Delors Plan and proposed to proceed with the first stage for the creation of the EMU on July 1st, 1990, it became necessary to hold detailed negotiations regarding the next stages of the EMU. These negotiations began with the Intergovernmental Conferences that were held in Rome in October 1990 and were concluded in Maastricht in 1991, with the decision to amend the Treaty of Rome in order to establish the EMU. The issues discussed at Maastricht also included the harmonisation of social policy in the EU, as well as the process to be followed for establishing a Common Foreign and Security Policy (CFSP).[1] In essence, the Intergovernmental Conferences discussed both the creation of the EMU, and the future establishment of a political union. Nevertheless, the discussions regarding the latter did not produce any concrete results.

The Maastricht Treaty was signed on February 07, 1992, and was ratified by all signatories on November 1, 1993. Above all, the treaty aimed at Europe's economic and political integration, way beyond the European Monetary System (EMS) and the Exchange Rate Mechanism (ERM), whose credibility had suffered huge blows at that time.[2] The Maastricht Treaty stipulated that the economic integration of Europe was conditional on the completion of the single European Economic Area through the circulation of the single European currency, the euro, the establishment of the ECB, and the elimination of a series of, official and unofficial, barriers that impeded the free movement of goods and services, people and capital across member states (Gilpin, 2000). The strategy pursued by the Maastricht Treaty stressed, above all, the importance of two principles: gradualism and convergence (De Grauwe, 2003, p.144).

Various key groups played a major role in the conclusion of the treaty. One of those groups was the Committee of Central Bank Governors, which modelled the ECB on the Deutsche Bundesbank Act, and "advocated the 'one person, one vote

1 The fields of foreign and social policy lie outside the scope of this study.

2 A series of major developments in 1992 and during the first half of 1993, caused a de facto EMS crisis. These developments shall not be discussed in this paper; it is worth remembering, though, that Europe's leaders had been stressing, through the Councils and the Commission, that the EMS was a key factor for stability and prosperity in Europe.