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Greece and the European Agenda:
EU Enlargement and European Monetary Union

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Abstract

In the decade to come, the European Union will embark on two new projects, each destined to transform it in fundamental ways: (i) Eastern enlargement, and (ii) economic and monetary union. Neither of these projects will affect all members equally or in the same way. But Greece will, for two reasons, be affected in a manner qualitatively different to all other member states. First, Greece is the only country physically affected by the Luxembourg Summit's decision to begin accession negotiations with some, but not all, Central and Eastern European applicant countries: as a result of this decision, she will continue, for at least another eight to ten years, to be the only member country not to share a common border with another member state, with all the consequent implications in economic and geostrategic terms. Second, when the European Council meets in early May to select those member states that are deemed to have met the convergence criteria, it will find that Greece is the only member state falling short of those criteria. This development may create additional difficulties for her economy during the transitional period of derogation. It will also pose new risks to Greece, insofar as she will be absent during the initial—and crucial—years of establishing a common monetary policy.

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The topic of this paper may seem at first glance as overly ambitious. Indeed, EU enlargement and EMU are each highly complex and risky projects in their own right, and no doubt should more properly be addressed separately.

However, as the emphasis here is on *Greece's* European agenda, rather than an in-depth analysis of the nature and effects of either enlargement or Economic and Monetary Union (EMU) *per se*, it may make sense to group together the two subject-matters which will change, more deeply than any other developments one can readily think of, at least in the foreseeable future, both the domestic Greek scene *and* Greece's external relations - and they both relate to developments linked to the future of the European Union (EU).

Where exactly do we stand in relation to the planned sequence of events? We are exactly 21 days away from the so-called European Conference, to be held in London, at which the British Presidency of the EU will launch the enlargement process, i.e. the set of multiple negotiations which will allow the eventual enlargement of the Union from the present membership of 15 countries to a Union of 26 member states.

We are also less than 2 ½ months away from the Special European Summit which will select those member states deemed qualified to participate in the so-called third stage of EMU, to begin on 1 January 1999 with the irrevocable fixing of exchange-rates - ironically, to be presided over by the Prime Minister of a country, Great Britain, which for the time being has chosen to opt out of the single currency.

Yet the interesting thing about these two events - enlargement and EMU - is that they will both affect Greece in a manner qualitatively different to any other member state. This represents the common underlying theme of this paper.

First, actual accession negotiations will commence with only six of the eleven candidate states. Cyprus, Hungary, Poland, the Czech Republic, Slovenia and Estonia are considered qualified to *begin* negotiations (when they will finish is in principle unrelated to this question). Latvia, Lithuania, Slovakia, Romania and Bulgaria will have to wait; however, in the meantime they will be included in the same, interim, "reinforced pre-accession strategy" as the first wave of entrants.

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But what will be the implications for Greece if the first group of countries does indeed join first, as is the most likely scenario? First and foremost, for some as yet unspecified time Greece will continue to be the only member state without a common border with another member state. During the Cold War especially, when Greece was separated from her Balkan hinterland by the Iron Curtain, this fact, needless to say, weighed particularly heavily on her economy. To understand the meaning of geography, one may wish to ponder the probable consequences for the U.S. economy if Canada were non-existent, and the United States shared, instead, most of its land borders with the Soviet Union. The importance of this factor can be further illustrated by reference to the zeal with which Germany has pursued eastern expansion, alleging the need for a stabilization of her eastern borders.

Therefore, Greece is the only EU member state whose geostrategic and geoeconomic position within Europe will be affected to such an important degree by the European Union's decision to begin negotiations with some, but not all, candidate countries. Partial enlargement will imply that, at least for the medium-term future, the benefits usually ascribed to EU enlargement, namely, the consolidation of peace and stability on the European continent and the promotion of economic development through integration, will, other things being equal, be of limited effect for some time in Europe's Southeastern peninsula. Of course, in the meantime it will be vital for Greece both to make the most of the existing provisions which govern trade and economic relations between the European Union and Bulgaria and Romania, *viz.* the Association Agreements that the European Union has concluded with all the Central and Eastern European candidates, and to cultivate the new opportunities offered by the opening of the economies of Greece's other neighbours, *viz.* Albania and the new republics which emerged from the former Yugoslavia.

The other major issue that had to be addressed at this juncture was the future of the Union's relations with both Turkey and Cyprus. Again, for Greece these two countries assume a much greater importance than for any other member state - indeed, Turkey represents the single most important and persistent foreign policy concern of Greece since independence, while the question of Cyprus has been preoccupying - some would say consuming - Greek governments, in one way or another, at least since the 1950s. Therefore, any decisions taken by the Union in this regard also would have a far greater impact on Greece than anywhere else in the EU.

Second, Greece seems on course to be the only country which will be unable, even though willing, to join EMU when it is launched on January 1st of next year. The establishment of a monetary union in Europe without Greece will have particular implications - of both an economic and a political nature - for Greece. It can be claimed that not joining the monetary union on 1 January 1999 will not have dramatic consequences for her, particularly if she manages to join in January 2001, as the Government hopes; however, being the only member state not yet meeting the Maastricht criteria will make for a relatively difficult transition period.

A. Enlargement

a.- A brief historical overview

The enlargement of the Union has been in the cards for quite some time. But it was at the Copenhagen Summit in June 1993 that the EU formally committed itself to admit the associated Central and Eastern European countries (CEECs) as members of the Union, *as soon as* these countries were able to satisfy the economic and political conditions for membership, *viz.*:

- the stability of democratic institutions
- respect for human rights
- the protection of minorities
- a functioning market economy, and
- the ability to implement the *acquis communautaire.*

However, no specific dates were offered to the candidates.

In the meantime, the European Union did not remain idle: during the first half of 1994, the EU, under the Greek Presidency, completed accession negotiations with Norway, Sweden, Finland and Austria, opening the way to the last three's membership as of 1 January 1995; the Union then embarked upon a 15-month long intergovernmental conference (IGC) with the aim of revising the Treaties, a process culminating with the new Treaty of Amsterdam, agreed in June 1997.

At the Cannes Summit in June 1995, the EU committed itself to begin negotiations with Cyprus and Malta six months after the end of the IGC.

One year later, at the Florence summit in June 1996, the Heads of State and Government expressed the wish that *"the initial phase of negotiations [with the CEECs] can coincide with the beginning of negotiations with Cyprus and Malta six months after the end of the IGC, taking its results into account"*[1]. At the time, it was not clear whether all the applicants would start together. This would depend basically on the progress each of them made in the direction of meeting the Copenhagen criteria. The Commission would deliver its recommendations soon after the IGC, after studying the progress each applicant had made in the meantime.

b.- The European Commission's recommendations: "Agenda 2000" (July 1997)

In July 1997, the Commission published its opinions on the state of preparedness of the candidate countries; the latter were part of a "communication"[2], produced in

[1] Presidency Conclusions.
[2] European Commission, *Agenda 2000*, COM(97) 2000 final.

response to a request from the Madrid European Council of December 1995, containing the Commission's wider recommendations on the broad perspectives for the development of the Union and its policies beyond the turn of the century, including an analysis of the future financial framework of the EU as from 31 December 1999. The Commission proposed beginning negotiations with the aforementioned six countries (Malta placed its application in abeyance soon after the October 1996 electoral victory of the Labour Party).

There are a number of reasons for this choice. The most obvious one was that not all candidates fulfiled the Copenhagen criteria. Indeed, the Commission even claimed that the five CEECs that it proposed to select did not "*fully satisfy all the criteria at the present time*". But it further argued that these countries "*could be in a position to satisfy all the conditions of membership in the medium term if they maintain and strongly sustain their efforts of preparation*"[1].

The other argument sometimes advanced was that the Commission lacked the personnel and manpower necessary to conduct parallel negotiations with such a large number of countries, implying that there had to be a cut-off point in the list of participants. There may be an element of truth in this view. Nonetheless, it is difficult to wholly subscribe to it because, if taken to its logical conclusion, it would mean that the second wave of candidates would not be allowed to start negotiations for another five or more years, a politically unacceptable prospect.

A third explanation is that opening negotiations with all eleven candidates would make the demand put forward by some member states that enlargement - between 2000 and 2006 - be financed within the current ceiling of 1.27% of EU GDP appear questionable. Opening negotiations with only six countries, including tiny Cyprus, Slovenia and Estonia would - in this view - somehow pre-empt the incumbent members who are net beneficiaries from the EU budget. These countries would ideally prefer to see an increase in the EC budget such as would enable the Union to finance the future enlargement without compromising its present structural and regional policies.

Turkey was a special case. The Commission, in its recommendation, reminded that Turkey's eligibility for EU membership, first raised in the 1964 Ankara Association Agreement, was reiterated in the Commission's 1989 opinion on Turkey's 1987 application for membership and reaffirmed on 29 April 1997 at the EU-Turkey Association Council, which added that Turkey would be judged by the same objective standards and criteria as the other applicants.

But the Commission also noted that Turkey suffered from certain weaknesses:

- the Customs Union, which came into force on 1 January 1996, proved the Turkish economy's ability to cope with the competitive challenge of free trade in manufactured

[1] European Commission, *Agenda 2000, For a Stronger and Wider Union*, Bulletin of the European Union, Supplement 5/97, p.57.

goods. But macroeconomic instability was a continuing cause for concern, including the cycle of inflation, public spending deficits and currency depreciation, as was a series of structural deficiencies. (It may be worth mentioning in this regard that inflation currently runs at over 100%);

- in political terms, Turkey had a government and parliament resulting from multi-party democratic elections; but at the same time "*Turkey's record on upholding the rights of the individual and freedom of expression fall well short of standards in the EU*"[1]. Reference was also made to the problem in the southeastern part of the country and the need to find a civil, not military, solution thereto, as well as to the particular role of the military in Turkish society.

The Commission went on to say that:

> "*The further pursuit of democratization in Turkey should be accompanied by a firm commitment to resolve a number of problems in the region (...) [T]ensions in the Aegean can be overcome only through the settlement of the issues between Greece and Turkey in accordance with international law, including means such as the International Court of Justice, as well as through good neighbourly relations and the rejection of the threat or use of force in accordance with the United Nations Charter. Moreover, Turkey should contribute actively to a just and lasting settlement of the Cyprus question in accordance with the relevant United Nations resolutions*"[2].

The Commission further stressed the role of the Association Agreement and the customs union in providing "*the foundations for building an increasingly close political and economic relationship which should evolve in parallel with the democratization process inside Turkey, progress towards lasting good-neighbourly relations towards Greece and the achievement of a just and lasting settlement in Cyprus*"[3].

Cyprus was also in a category of its own. In July 1993 the Commission delivered a favourable opinion on Cyprus's 1990 application for membership. In its July 1997 report, the Commission confirmed its earlier views.

But it also went on to note the problems associated with the continuing division of the island, pointing out that the present *status quo* "*not only threatens the stability of the island and the region but also has implications for the security of Europe as a whole*"[4]. The Commission further argued that "*The prospects for [...] a settlement could be improved by the decision to open negotiations*"[5], a view first put forward by the Secretary-General of the United Nations.

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[1] *Ibid.*, p.56.
[2] *Ibid.*.
[3] *Ibid.*, pp.56-7.
[4] *Ibid.*, p.55.
[5] *Ibid.*

The Commission also stressed that negotiations on accession would be facilitated if representatives of the Turkish-Cypriot community could "*be involved in the accession process*". However, if attempts to secure this participation did not succeed, negotiations "*should be opened with the government of the Republic of Cyprus, as the only authority recognized by international law*"[1].

The potentially most controversial - due to its relative ambiguity - passage in the Commission's report is one stating that "*a political settlement would permit a faster conclusion to the negotiations*"[2]. The implied corollary of this assertion is that the *non*-achievement of a political settlement could entail some as yet unspecified costs for Cyprus.

c.- The Luxembourg European Council (12-13 December 1997)

These, then, were the recommendations put forward by the Commission last July.

The EU governments were faced with a difficult situation. The main problem was how to make the wider enlargement process seem all-encompassing, thereby avoiding accusations that the EU was introducing new dividing lines within Eastern Europe, when it was fairly clear that there were considerable economic and political differences among the applicant countries. Furthermore, some member states believed more strongly than others that, irrespective of when the negotiations with each of the candidate countries would come to a conclusion, it was strategically important to engage all of the candidate countries in a concurrent negotiation process; not to do so entailed the risk of inducing a rejection-based backlash or backtracking in the countries left out of the first wave of enlargement negotiations.

This latter group of member states, *i.e.* those that wanted negotiations to begin simultaneously with all ten CEECs, included Sweden, Denmark, Spain, Italy and, up to the last minute, Greece. The two Scandinavian countries were interested above all in bringing into the process the two Baltic States, Lithuania and Latvia, neighbouring countries also of considerable economic interest to them. Spain was unhappy about Dutch and German-led demands that enlargement be financed within the current fiscal ceiling; a bigger group of negotiating candidates would make this stance less tenable. Italy was motivated mainly by pure pan-European strategic concerns, while Greece was mostly interested in securing the advantages of eventual membership to her Balkan neighbours, for economic and geostrategic reasons of her own.

The die was cast at the Luxembourg Summit, which was held on 12-13 December 1997. Previously, Italy had sided with the Commission's proposals, while the two Scandinavian countries did not even manage to secure the support of their Nordic cousin Finland, which considered that allowing negotiations to begin with Estonia alone among

[1] *Ibid.*
[2] *Ibid.*

the Baltic states would act as a strong incentive on Lithuania and Latvia to accelerate their reforms.

How did the Luxembourg Summit face up to the conundrum of having to satisfy the expectations of four disparate groups of countries?

The first group consisted of Cyprus, the only country whose territory was partly under foreign occupation. This fact could still lead to her bid to join the European Union being thwarted by one or more reluctant member states. It would be crucially important to see, then, what the European Council had to say about her case.

The second group consisted of the Commission's preferred candidates.

The third group comprised those countries with whom the Commission recommended the opening of negotiations only in a second round of enlargement negotiations. In this connection, it would be important to see how the Union would try to assuage these countries' disappointment.

Fourthly, there was Turkey, a country in principle eligible for EU membership, but with which the European Union was loath to begin negotiations, even as it feared alienating her irremediably following the prospect of a second rejection in less than ten years.

In Luxembourg, a number of decisions were taken:

1) Following an earlier French proposal, it was decided to set up a European Conference bringing together the EU's member states and all the European countries aspiring to join the European Union and sharing its values and objectives. It was stipulated that:

> "*The members of the Conference must share a common commitment to peace, security and good neighbourliness, respect for other countries' sovereignty, the principles upon which the European Union is founded, the integrity and inviolability of external borders and the principles of international law and a commitment to the settlement of territorial disputes by peaceful means, in particular through the jurisdiction of the International Court of Justice in the Hague. Countries which endorse these principles and respect the right of any European country fulfilling the required criteria to accede to the European Union and sharing the Union's commitment to building a Europe free of the divisions and difficulties of the past will be invited to take part in the Conference.*"

The European Conference will be a standing, multi-lateral forum of political consultations with a view to a strengthening of cooperation in the fields of foreign and security policy, of justice and home affairs and other areas of common interest, especially the economy and regional cooperation. The Conference will meet once a year at the level of Heads of State and Government and the President of the Commission, and once a year at the level of Foreign Ministers. The first meeting is scheduled to take place in London, on March 12, 1998.

To all but the most naïve, this exercise has only one object: to include Turkey in the new flurry of diplomatic activity in Europe without actually committing the Union to bringing Turkey in as a full member of the EU. It is for this very simple reason that (a) Turkey rejected the invitation, and (b) Greece opposed the idea from the outset, considering such a conference superfluous. But she was practically alone in this, with similar views being held only in Bonn. In the end she had to give way to her partners' desire to hold the Conference - but not before the aforementioned conditions relating to human rights, the peaceful settlement of disputes, etc. were spelled out.

2) The Luxembourg Summit decided to launch a process of accession which will include the ten Central and Eastern European candidate countries and Cyprus. This will begin with a meeting of the Foreign Ministers of the countries involved, on 30 March 1998, in London. All candidates will participate under the same conditions in this process of accession. Relations with the ten CEECs will be based, alongside their Association Agreements, on a new framework called the "re-inforced pre-accession strategy", involving (i) the establishment of "partnerships for accession", whose aim will essentially be to assist the candidates in identifying priorities and taking on board the EU *acquis communautaire*, as well as (ii) greater financial assistance.

3) The Luxembourg Summit decided to begin, in April this year, bilateral negotiations with the governments of Cyprus, Hungary, Poland, Estonia, the Czech Republic and Slovenia. (These will actually begin on March 30-31, 1998.)

At the same time, preparations for the negotiations involving Romania, Slovakia, Latvia, Lithuania and Bulgaria would be speeded up on the basis of an examination of these countries' incorporation of the Union's *acquis*. In the light of the Commission's relevant reports, bilateral accession negotiations with these countries could theoretically begin as early as the beginning of next year.

With respect to Cyprus, the European Council repeated the time-honoured principle that membership must be to the benefit of both communities in Cyprus (an exhortation figuring in the preambles of all formal European Community-Cyprus texts), and reiterated the argument that accession negotiations will have a positive influence on the efforts towards a political solution to the problem of Cyprus. The European Council expressed, furthermore, the hope that the Cypriot government's offer to include representatives of the Turkish-Cypriot community in the Cypriot delegation would be accepted by the Turkish-Cypriot leadership. The European Council did not allude either to the - not unreal - possibility of negotiations being concluded before a political solution is found, or to the possible consequences of such a development.

The Turkish-Cypriot leadership disagrees entirely with this approach, and considers Cyprus's application to join the EU as a unilateral move by the Greek-Cypriots. It expects the Turkish-Cypriots to be treated as "equal" partners in the membership negotiations, not as a minority, *i.e.* any Turkish-Cypriot representatives to the negotiating team of Cyprus would have to have "equal" status. Furthermore, this pre-supposes, in addition, prior membership of Turkey to the European Union, as EU membership for the Turkish-Cypriots in a Union in which Turkey were absent would leave them "defenceless". At the time of writing, the Turkish-Cypriot side had rejected altogether the concept of a single negotiating team for Cyprus, thereby dashing the hopes of those who looked to Cyprus's negotiations to join the EU acting as the "greenhouse" for a common administration in the future. As recently as 16 February 1998, Rauf Denktash said that the formal opening of negotiations in March would bring "everything that has to do with intercommunal talks to a stop"[1].

It would not be unrealistic to expect that one or more EU governments will try to convince the new government in Cyprus to offer concessions to the other side with a view to persuading it to appoint representatives to Cyprus's negotiating team. These concessions could include the sharing of EU financial aid or the acquiescing to the export of Turkish-Cypriot fresh produce to EU countries (presently banned in the European Union for being unaccompanied by the proper official documents).

4) The Luxembourg Summit, in its written conclusions, devoted a special section to Turkey. In it, it reaffirmed Turkey's eligibility for membership, to be judged by the same criteria as apply to the other candidate countries. But it also noted that Turkey did not fulfil all the political and economic preconditions which would enable the Union to examine the possibility of opening up membership negotiations with her. Instead, the European Council formulated a strategy to enable Turkey to become better prepared for eventual membership. This strategy would be based on an intensification of the 1964 Association Agreement and the 1996 Customs Union, the further approximation of Turkish laws towards the *acquis communautaire*, the participation of Turkey in various Community programmes and Community bodies, as well as the implementation of financial cooperation. Greece has said it will hold up EU financial assistance of Ecu375m and of a further Ecu750 million credit facility until Turkey decides to agree with a Greek proposal to take the Imia issue[2] to the ICJ. This position is not without costs for Greece as regards her relations with her EU partners. All other member states wish to activate the financial protocol, and to this end have been demanding that Greece lift her veto.

However, what ostensibly led Turkey to reject the EU's invitation to participate in the European Conference was the paragraph that stipulated that:

> "*The European Council recalls that strengthening Turkey's links with the European Union also depends on that country's pursuit of the political and economic reforms on which it has embarked, including the alignment of human*

[1] *Financial Times*, 17 February 1998.
[2] See below, p. 14.

rights standards and practices on those in force in the European Union; respect for and protection of minorities; the establishment of satisfactory and stable relations between Greece and Turkey; the settlement of disputes, in particular by legal process, including the International Court of Justice; and support for negotiations under the aegis of the UN on a political settlement in Cyprus on the basis of the relevant UN Security Council Resolutions."

These conditions were termed as unacceptable by Turkey, whereupon Ankara announced the freezing of her political dialogue with the EU, as well as the breaking off of a series of meetings between a group of "experts" - held since last Spring following an EU initiative - who had been exploring possible approaches for setting up a framework for settling disputes between Greece and Turkey. Instead, Turkey proposed that efforts to resolve differences be pursued "directly by Greece and Turkey", through official contacts.

The British Presidency has declared that it will persevere in its efforts to persuade Turkey to attend the first meeting of the European Conference and, failing that, to join it at any point thereafter. Presumably, all that this would require on Turkey's part would be a letter of reply stating that Turkey abides by these principles (no monitoring mechanism in the strict sense is provided for in the Summit's conclusions). Turkey's rejection of the invitation reflects, of course, a deeper frustration with the EU's decision to relegate her to a third category of candidate states, behind Bulgaria and Romania. Participation would also imply that Turkey accepted Cyprus's eligibility for membership, something Turkey has always objected to[1]. Turkey's reaction also reflects a belief that the EU can no longer act as an "honest broker" between Greece and Turkey, as Greece is a member of the EU and can therefore influence the Union's positions. However, it can be claimed that this view underestimates the importance the EU attaches to the achievement of high political standards for all with whom it is closely involved, let alone potential members. The EU did not, for example, include Slovakia in the first wave of candidates, for political reasons; Slovakia is ahead of almost all other candidates in economic terms.

d.- Conclusions for Greece's Foreign Policy

In the short- to medium-term, Greece's foreign policy seems obliged to proceed along more or less familiar patterns.

As has been argued above, Bulgaria's and Romania's insufficient progress means that these countries will have to wait until their reforms appear sufficiently deep-rooted and sustainable before bilateral accession negotiations can commence. If one takes the case of Spain and Portugal as an example - these countries' accession negotiations took seven years to complete - one could venture the prediction that Romania's and Bulgaria's accession will not happen before 2006 at the earliest. The case of Albania and the states

[1] It is reminded that the European Council expected countries which participated in the European Conference to "*respect the right of any European country fulfilling the required criteria to accede to the European Union*".

that emerged from the former Yugoslavia (except Slovenia) is too uncertain to allow any predictions at this stage.

Bulgaria seems to have made some notable progress since April 1997 when the Union of Democratic Forces came to power, having to face what a year ago looked like impending economic collapse, including a grave financial and banking crisis accompanied by a run on the lev and the closure of over a dozen banks. Stabilization has made progress, privatization less so (about 80 to 85% of the economy is still in the hand of the State). An IMF-prescribed currency board financial system was introduced to provide a fixed currency base and to prevent the government from indulging in deficit-financing or bailing out of banks. The 1998 target for inflation is 16%, but many consider this too optimistic. The IMF expects slower growth in 1998 than government estimates of 4%[1]. Greece is Bulgaria's third most important trading partner, behind Germany and Italy[2]. Greece ranks 8th in terms of foreign investment. In February 1998 it was announced that a joint Greek-Bulgarian-Russian firm will probably be set up with the purpose of beginning preparations for construction work on the $750m Burgas-Alexandroupolis pipeline[3].

Romania's reforms have, until recently, been painfully slow, exacerbated by a weak and inexperienced administration. With only $3.5bn of foreign direct investment since the collapse of communism, Romania is still lagging far behind Poland, the Czech Republic and Hungary[4]. However, since the early 1997 "shock therapy" package of reforms, the budget deficit was reduced to 4.5% of GDP (from 10% in 1996), the exchange rate was freed, subsidies reduced substantially, while the pace of privatization was stepped up. Inflation is anticipated to fall from an annualized 150% in 1997 to 20% in 1999. These reforms have taken their toll on the Romanian economy: in its latest country report, the OECD estimates that the Romanian economy shrank by 6.5% in 1997; but it is expected to grow by 1% this year and 3% in 1999[5]. Greece ranks 13th in foreign investment in Romania, with 1,700 Greek businesses active on Romanian soil. Greece ranks 7th in both exports to and imports from Romania[6].

With respect to the Former Yugoslav Republic of Macedonia and Albania, the Union has adopted a policy of encouragement, based on "cooperation agreements", coupled with financial assistance. The EU-Fyrom Cooperation Agreement was signed on 29 April 1997 and came into effect on 1 January 1998[7]. The EU-Albania cooperation

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[1] See, *e.g.*, "IMF Set to Help as Bulgarian Economy Comes Back to Life", *Financial Times*, 12 February 1998.

[2] *Agence Europe*, 9 January 1998.

[3] *Athens News Agency*, 12 February 1998.

[4] See *Financial Times*, "Romania Tests Investors' Patience", 18 February 1998.

[5] See also *The Economist*, 28 February 1998, p.112.

[6] *Athens News Agency*, 24 November 1997.

[7] The aim of the agreement is to promote global cooperation in all fields with a view to contributing to Fyrom's economic development (especially by introducing a market economy), as well as to strengthen bilateral relations in general. The Agreement contains provisions for economic, technical and financial cooperation in several fields, including industrial development, small-and-medium-sized enterprises, investments, science and technology, transport, tourism, agriculture, public health, the environment and

agreement was signed in 1992, but was subsequently suspended by the EU as a result of political upheaval in that country. A reactivation of the agreement seems imminent[1]. However, these countries' economies are presently too weak to withstand much trade liberalization. Greek investments in Albania rank second in terms of size of invested capital, after Italy, while Albania ranks ninth among importers of Greek goods[2]. Fyrom and Albania both fall within the EU's "strategy of conditionality", along with Bosnia-Herzegovina, Croatia and the Federal Republic of Yugoslavia. This strategy aims to place at the center of reinforced relations progress made in the respect of democratic principles, human rights and the rule of law, economic reforms, promotion of regional cooperation, as well as respect for the implementation of the obligations stemming from the Peace Agreements. The Greek-Fyrom dispute over the latter country's name has not been resolved, and negotiations are continuing under the aegis of the United Nations. However, the UN-sponsored interim agreement of 13 September 1995 has otherwise allowed the normalization of relations between the two countries to proceed fairly smoothly, in particular economic relations.

The European Union's policy with respect to the Federal Republic of Yugoslavia, Croatia[3] and Bosnia-Herzegovina is essentially guided by the abovementioned principle of "conditionality", namely compliance with the Dayton Accords. Clearly, it is too early to envisage an institutionalisation of relations with the EU in the usual sense.

With respect to Turkey, it is difficult not to be pessimistic, on the one hand as regards her "European" prospects and her ability to abide in practice by the conditions set by the EU in Luxembourg, and on the other as regards her relations with Greece. Greece argues that she has a very narrow margin of manoeuvre as far as options for possible concessions are concerned, and will tend to barricade herself behind international law and the relevant EU positions.

One sign of change, however, is the Greek government's new willingness to put *any* issue put forward by Turkey before the ICJ, even those she traditionally considered as

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intellectual property. This cooperation may rest on the Phare program, for which Fyrom is eligible. The agreement also confirms the preferential system for the import into the EU of industrial products originating from Fyrom; certain agricultural products also benefit from import facilities into the EU. EU exports to Fyrom benefit from the most-favoured-nation régime. The EU is also granting Fyrom Ecu40m in macro-financial aid (intended to strengthen currency reserves), as well as loan guarantees enabling the European Investment Bank to lend the country up to Ecu150m between early 1998 and 31 December 2000. See *Agence Europe*, 22 January 1998.

[1] Albania has received between 1991 and 1997 Ecu557m in aid for reconstruction. In October 1997, at a conference of international donors, the EU undertook to grant further assistance of Ecu100m. In 1998 a further Ecu42m will be released in the framework of the Phare program. Humanitarian aid of over 10m has been granted since December 1997. *Agence Europe*, 28 January 1998.

[2] *Athens News Agency*, 31 January 1998.

[3] Croatia signed, in December 1997, a free-trade agreement with Slovenia; the latter came into force on 1 January 1998. This is regarded as a first step toward membership of the Central European Free Trade Association (Cefta), which includes six countries - the Czech Republic, Hungary, Poland, Romania, Slovakia and Slovenia. However, membership of Cefta pre-supposes an association agreement with the EU, which Croatia does not have.

amounting to unilateral Turkish claims on Greek sovereignty, on which grounds any discussion hitherto was rejected out of hand. On January 25, 1998 the Greek Foreign Minister announced - to the dismay of the parliamentary opposition - that the issues that could be referred to the International Court of Justice included (i) the demarcation of the Aegean continental shelf, (ii) the determination of national air space, (iii) the delineation of territorial waters and (iv) the arming of Greece's eastern Aegean islands. Only the continental shelf question had been considered until recently as a real issue properly requiring bilateral negotiations and, eventually, international adjudication[1]. For its part, the question of territorial waters is considered so vital to Turkey that she has declared that a possible extension of Greek territorial waters from 6 nautical miles to 12 n.m. would constitute a *causus belli*. (Greece claims such an extension as a right based on the Law of the Sea[2]; however, successive Greek governments have announced that they will not exercise this right for the time being, while retaining the option to do so eventually.)

Turkey maintains that all these questions fall outside the ambit of International Law, and that, by reason of their allegedly peculiar nature, require a "political" solution, to be arrived at essentially on a bilateral basis.

The reason a certain pessimism is arguably called for is because of the discernible long pattern of escalating claims in the Aegean on the part of Turkey, beginning with the continental shelf issue in 1973, moving on the following year - the year of the Cyprus invasion - to the question of Greece's 10 mile air space (which does not coincide with her territorial waters of 6 nautical miles, in contravention - according to some[3] - of international law), and culminating in 1996 with the most serious incident in recent memory, the Imia incident; the latter, regardless of its origins, brought the two countries to the brink of a military clash over an uninhabited islet in the Eastern Aegean, and involved among other actions the mobilization of the two countries' naval forces and a landing of Turkish troops on the disputed rock. This subsequently spawned wide-ranging and nebulous Turkish claims over large numbers of Greek islands, including Gavdos, off the SW coast of Crete.

From Turkey's point of view, these issues have value less for their individual merit, and more for their ability to form a growing body of demands which Greece finds increasingly difficult to contain, let alone neutralize. Though from Turkey's point of view the accumulation of claims may be considered as enhancing her bargaining position, from Greece's point of view the facts (i) that these claims have emerged in a cumulative and seemingly open-ended fashion over a 25-year period and (ii) that they are considered by

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[1] Turkey does not consider the Aegean islands as entitled to a continental shelf.

[2] Greece signed the 1982 United Nations Convention on the Law of the Sea, and ratified it on 21 July 1995. Turkey has neither signed nor ratified it. The United States has neither signed nor ratified it. The convention entered into force on 16 November 1994, 12 months after the date of deposit of the sixtieth instrument of ratification or accession.

[3] Byron Theodoropoulos (former Ambassador and Secretary-General of the Hellenic Ministry of Foreign Affairs, *To Vima*, 1 February 1998.

Turkey as not amenable to resolution on the basis of International Law, but rather as matters to be resolved bilaterally, are seen as evidence of Turkey's bad faith, at best, and expansionary aims, at worst.

With respect to Cyprus, it remains to be seen whether the European Council's decision to allow accession negotiations to begin will act as the catalyst for a political solution to the division of the island it is proclaimed to be. So far it has caused a hardening of the Turkish side's position. On the other hand, the prospect of Cypriot membership may be too attractive a prospect for the Turkish-Cypriot side to ignore.

Yet, there remains some ambiguity as to what would happen if accession negotiations were to come to an end prior to a political solution. This ambiguity has opened the door to considerable debate.

There are those who argue that admitting a divided Cyprus would lead to insurmountable political problems. France, for one, is openly opposed to the non-participation of the Turkish-Cypriot community in the forthcoming negotiations with the Government of Cyprus, and at Luxembourg reportedly sought to postpone the opening of negotiations until the participation of Turkish-Cypriot representatives had been secured[1]. The current British Presidency might also have been emitting mixed signals: on the one hand, it has reportedly attempted, during a recent EU experts' meeting charged with finalizing the EU's opening positions at the start of the inter-governmental negotiations with the six candidate countries, to introduce pre-conditions to Cypriot membership, in the form of a reference to the effect that the accession of Cyprus to the EU necessitated the creation of a bi-communal and bi-zonal federation[2]; on the other hand, the British special envoy on Cyprus has, according to press reports, stated publicly that a political solution to the Cyprus problem is not a pre-condition for accession[3].

Other member states, most prominently Greece, of course, claim that Cyprus, the victim of a military occupation, cannot be held hostage to the policies of a third, non-member state, namely Turkey[4]. The concept of "constructive ambiguity" is used informally

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[1] At the Luxembourg Summit, the Greek Prime Minister reported, in his press conference, that France in particular had expressed objections to the start of negotiations for the accession of Cyprus to the EU. The British Prime Minister, on the other hand, stated publicly that a solution to the Cyprus issue does not constitute a precondition for accession, thereby distancing himself publicly from the positions of the French President vis-à-vis Cyprus. *Athens News Agency*, 15 December 1997).

[2] *Athens News Agency*, 28 February 1998.

[3] *Ta Nea* (Athens daily newspaper) reported Sir David Hannay's remarks during a visit to Cyprus, 28 February 1998.

[4] The British government took a similar position in the wake of the Luxembourg summit. The following press report is illustrative of this:

"BRUSSELS 17/12/1997 (AFP/REUTERS/ANA)

British Foreign Secretary Robin Cook, speaking here yesterday, warned Ankara against any attempt to annex the Turkish-occupied part of Cyprus.

"Any attempt by Turkey to annex the northern part of Cyprus will be in opposition to international law," said Mr. Cook during a press conference on the sidelines of a NATO ministerial meeting.

within the Council Secretariat to describe how lack of clarity as regards the Union's ultimate stance with respect to the final stage of the process can act as an incentive on both sides of the divide in Cyprus to make concessions.

At this point it may be worth pointing out that, from a strictly *legal* point of view, there are in principle no obstacles to admitting Cyprus in the event that a political solution has not been achieved by the time of the conclusion of the negotiations[1]. The EC-Cyprus Customs Union Agreement was signed with Greek Cyprus on behalf of the whole country. Also, there is the German precedent, *viz.* Bonn's signing of the Treaty of Rome in 1957 with the proviso that when one day Germany would be reunited, East Germany would automatically accede to the European Community by virtue of its becoming a part of the Federal Republic; this is exactly what happened. The *politics* of the question is an entirely different matter: without a prior settlement, admitting Cyprus would imply a state of violation of the EU's external borders[2] and the occupation, by a foreign power, of a part of the EU's territory. This would directly place the Cypriot problem inside the territorial confines of the Union itself; understandably, this might be considered too excessive a political complication to bear for most Europeans.

In principle, therefore, one cannot rule out the possibility that one or more countries, for political reasons, veto Cyprus's accession: according to EU rules, any draft accession treaty will have to be submitted to the Council for a unanimous decision (as well as be ratified by the national parliaments). However, the Greek side has stressed that Cyprus's accession to the European Union cannot be isolated from the EU enlargement process as a whole, and is linked with the accession of other candidate countries. This means that for Greece enlargement can only proceed with all candidate countries, or with none.

"If Turkey wishes to become a member of the EU, it cannot do so by blocking the admission of another country," he added.

Yesterday, Turkish Foreign Minister Ismail Cem threatened that Ankara would proceed with the annexation if the EU began admission talks with the Cypriot government next March.

At last week's EU Luxembourg summit, the Union's 15 leaders rejected Turkey's membership application but, however, invited Ankara to attend the European Conference, to be held in Britain next year.

"We left the door open, we advise Turkey to walk in," Mr. Cook said last night. [...]

In London, Foreign Office Minister Doug Henderson told reporters that Turkish objections should not be allowed to hold up negotiations on the admission of Cyprus into the EU. He said that on that issue, "no other nation has a say", adding that he hoped the Turkish government will realise the benefit it will have in taking part in the European Conference."

[1] Unless, of course, Turkey carries out its threat to annex the northern part of the country. In this case, Turkey's *de facto* rule on the territory of a member state (Cyprus) would mean that EU law and the law of a sovereign, and recognized, state's (Turkey's) would be in direct conflict with one another.

[2] Article J.1 of the Amsterdam Treaty stipulates that the objectives of the Union will include "the preservation of peace and the strengthening of international security, in accordance with the principles of the United Nations Charter, as well as the principles of the Helsinki Final Act and the objectives of the Paris Charter, including those on *external borders*" (our emphasis).

Finally, from a strictly tactical point of view, one could argue that, to the extent that the European Union may appear prone to indulging in "constructive ambiguity" - at least on some occasions and perhaps at lower levels of officialdom - such a stance will tend to undermine its ability to achieve its own stated goal - *viz.*, to proceed with the Cypriot accession process as a means of breaking out of the present stalemate, ideally by bringing the two sides to work toward an *ex hypothesi* desirable common goal. In so far as such ambiguity is perceived as ambivalence on the part of the Union, this would tend to weaken any incentive effect the EU's declared preparedness to proceed unconditionally with Cypriot membership could have on Ankara and, especially, the Turkish-Cypriot community. As is often the case, Greece's diplomatic efforts within the EU institutions will no doubt, to a large extent, be expended on ensuring that there is no divergence from, unfavourable reinterpretation of, or tactical disregard for, established EU positions and principles.

B. Economic and Monetary Union

The launching of monetary union, with the irrevocable locking of exchange rates on 1 January 1999, is probably the most spectacular move in forty years of European economic integration. Following on the construction of the Common/Single Market after forty years of efforts, the member states will embark on a new qualitative step on the path to integration, the single currency. Though there is considerable argument about this, various indications lead to the suggestion that EMU will not be a self-contained development, but rather will act as a launching pad for further moves towards economic and political integration.

As mentioned in the introduction, Greece will probably be the only member state willing to join EMU from the start but unable to do so for failing to meet the Maastricht convergence criteria on time. The three countries that are unwilling to join at the outset - the UK, Sweden, Denmark - will no doubt meet the criteria[1].

This leaves Greece as the only country in the EU facing the imminent establishment of a euro-zone within her main international trading area, while at the same time experiencing significantly higher inflation than her main trading partners - 4.5% vs. less than 2%.

It follows that one could reasonably question the validity of the Greek monetary authorities insistence on the current "strong currency" stance[2].

A "pre-in" country like Greece will experience two kinds of repercussions:

α.- economic, and

β.- institutional/political.

a.- Economic risks: exchange-rate volatility

The most important economic consequence is that Greece's currency, the drachma, will probably come under increased pressure. The external value of the drachma will come under greater scrutiny than in the past, when currency traders were busy observing not only the drachma, but also the Italian lira, the French franc, the Portuguese escudo, or the British pound sterling, to detect any divergence between announced policies and actual performance, any discrepancy translating into a fall in credibility and perceived sustainability. Now, the continental currencies will become one. Speculators

[1] For the UK and Sweden, this does not include the criterion on participation in the Exchange Rate Mechanism of the European Monetary System for at least two years, as stipulated in Article 109j paragraph 1 of the Treaty on European Union.
[2] The Central Bank of Greece, in lign with the Maastricht Treaty's requirements concerning the second stage of EMU, became independent on 19 December 1997.

aiming to make a profit from a possible currency devaluation in Europe will direct their attention to the drachma.

The matter of investors' confidence in the drachma - and its vulnerability - is one of much debate. On the negative side, attacks on the drachma were observed in 1994, in November 1997, as well as in late December 1997 and early January 1998. Also, the Asian financial crisis seems to have affected the Greek bond and currency markets more seriously than their European counterparts, leading to more general speculation about the strength of the Greek economy. In all cases, the Greek monetary authorities responded by raising interest rates, thereby averting pressures for a devaluation. But raising interest rates, apart from distancing Greece further from the Maastricht objectives[1], increase the cost of borrowing for domestic producers, who have already suffered appreciably as a result, and raises the cost of servicing the public debt. It is precisely this willingness on the part of the monetary authorities to inflict pain on the productive base of the economy for protracted periods that speculators question.

On the positive side, all three speculative attacks against the drachma - 1994, November 1997, December 1997-January 1998 - were thwarted. Most speculators lost money; but some profited by speculating on the prospect of higher interest rates. The structure of the Greek banking system also contributes to the defence of the drachma, as 2/3 of the drachma market is controlled by the Government via the state banks; the latter usually do not follow any run on the currency. Furthermore, any rise in inter-bank interest rates is not fully reflected in the interest rates the state-owned commercial banks charge borrowing customers, the difference translating into a decline in their profits[2]. Even private banks in Greece have shown themselves loath to speculate against the drachma, for fear of re-igniting inflation. Moreover, Greek firms increasingly borrow from abroad, thus by-passing the higher domestic interest rates. Greece's foreign exchange reserves have increased in recent years, which also enhances significantly the monetary authorities' ability to withstand speculative attacks: from $1bn in 1992 and $3bn in 1994, they stood at $11bn last October and $13bn at present. Finally, inflation is falling, which - other things being equal - reduces the scope for speculative activity. As a result of these favourable trends, moreover, interest rates on government bonds fell at the latest Finance Ministry's auction of treasury bills, after a rising trend in the preceding two months. But they still stand at 13.1%[3], which is more than twice as high as in the rest of the EU. (The Finance Ministry estimates that the average rate for 1998 will fall to 8.9%.[4])

Why is the Government so adamant in its commitment to preserve its "strong currency" stance? The answer is that, after weighing costs and benefits, it considers that it

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[1] These require that, observed over a period of one year before the examination, a member state has had an average nominal long-term interest rate that does not exceed by more than 2 percentage points that of, at most, the three best performing member states in terms of price stability.

[2] Despite this effect, banks' reported profits for 1997 were considerably higher than in the previous year. See, e.g., *EXPRESS* (daily Athens financial newspaper), 27 February 1998.

[3] *Athens News Agency*, 17 February 1998.

[4] *Express*, Athens, 17 February 1998.

is preferable to stay the course, having already gone as far as it has: a devaluation, in order to prove effective, is considered by the government as requiring a simultaneous freezing of wages and prices for a considerable period, which entails costs and inefficiencies of its own - apart from not being considered politically feasible at the present time. Without a freeze, devaluation could well provoke higher inflation and thereby push Greece further away from the Maastricht criteria. And one devaluation would possibly open the door to a pattern of repeated realignments. This is what happened after the 1983 devaluation: the ensuing economic conditions ensured that a new devaluation became unavoidable by 1985. In the aftermath of these negative experiences, Greece embarked on a stable currency policy, which on the whole it has pursued and adhered to ever since.

However, none of these factors and arguments are foolproof. They provide no absolute guarantee for the future. What could the Greek government do to bolster its future defences against speculative attacks of the sort just described, bearing in mind the high costs implicit in the current policy of periodically raising interest rates?

To repeat, speculative attacks have their origin in a perception that a currency is "overvalued"; that the government of the country in question will finally decide that the country would be better off if the currency were devalued. At the root of such assessments lies a perception that the national economy suffers from a *lack of competitiveness*. In other words, a perception that a country is pricing its exports out of international markets, running deficits on its foreign trade account and suffering high unemployment and low growth in order to maintain artificially the external value of its currency. (In Greece, the country's trade deficit appeared to widen to $15.49bn in the period January-October 1997, up by 2.34% compared with $15.13bn in the same period in 1996.[1])

How can one address the problem of competitiveness if adjustments of the exchange rate are not considered a viable policy instrument? The answer, of course, lies in adjustments to the structure of the real economy itself. Greece has some of the most inflexible labour markets in Europe, as well as one of the largest and least productive state sectors. Introducing improvements in these areas would not only prepare Greece better for monetary union, but would also help reduce the government's budget deficit; this would relieve pressure on interest rates and mitigate the fiscal drag implicit in the Government's current policy of relying more on higher taxes, than on reduced expenditures, in order to reduce budget deficits, both of which effects today act as a restraint on economic growth.

Belatedly, the Government seems willing to acknowledge these facts and to be prepared to take concrete measures - prodded perhaps by the recent scares on the currency markets and its disappointment at discovering that Greece would be alone, among the countries aiming to join the monetary union, that would not qualify for the first wave of entrants. The Government has finally challenged the unions' grip on public sector enterprises. Parliament early in February 1998 approved legislation to restrict collective bargaining rights at four state-controlled corporations with a history of high deficits and difficult union-management relations (Olympic Airways, the Post Office, Hellenic

[1] *Athens News Agency*, 30 January 1998.

Railways, the Athens bus company[1]). This is supposed to mark the start of a campaign to cut costs at a group of thirty-six state companies, mainly utilities and transport organisations, which are to be restructured and partially privatised. It was also announced recently that three state-run banks will also be privatised within the next six months (Macedonia-Thrace, Central Greece, Crete). But much, much more needs to be done[2].

b.- Institutional/political risks: second-class status?

What are the institutional/political dangers inherent in belonging to the slow track?

It was suggested earlier that monetary integration would probably open the way towards more economic and political integration.

A historical review of what happened in other countries which proceeded to monetary union, such as the United States after the Civil War and Germany in the 1860s, indicates that moves to a more centralised, federal type of government there *preceded* monetary integration[3].

Of course, the European Union is not constrained by history, but nor does it have a blueprint for where it is heading.

Nonetheless, some directions may be discerned, based on the recent Intergovernmental Conference (IGC), as witnessed by this writer[4].

Though this IGC was not about creating new areas of competence for the Community at the expense of the member states, the Amsterdam negotiations ended taking *some* decisions in the direction of a more federal-type of organisation (*e.g.* making the European Parliament a co-legislator on a par with the Council; introducing the wider use of qualified majority voting in common foreign and security policy (CFSP); transferring cooperation in matters of asylum and immigration to the so-called 1st pillar of the Union structure, where Community competence applies - albeit with a transitional period during which unanimity will continue to be the rule).

[1] The *Financial Times* reports that the Athens Bus Company alone has accumulated debts of over $2.4bn, equal to about 2.1% of GDP. *Financial Times*, 5 February 1998, p.3.

[2] According to the *Wall Street Journal's* 1998 Index of Economic Freedom, Greece ranks 66th out of 156 countries.

[3] In Italy and Switzerland political union in the mid-1800s also preceded monetary union but, in Switzerland at least, managed to operate with a fairly decentralized form of government. In monetary unions where political integration did not ensue, such as the Latin Monetary Union, 1865-1925, the German-Austrian Monetary Union, 1857-1867, and the Scandinavian Monetary Union, 1872-1931, monetary union did not last. Nonetheless, a life-span of sixty years in the first case and fifty-nine in the last is an achievemnt well worth noting.

[4] As a member of the Greek negotiating team to the IGC.

However, probably even more significant for the future of the Union than the above reforms was the strong desire expressed by many member states, including France, Germany, Italy, Finland, Austria and the Benelux countries, as well as the Commission itself, to introduce new clauses on "flexibility". This would allow sub-sets of countries, over the objections of a minority, to avail themselves of Community institutions and mechanisms in order to forge ahead in new areas. Paradoxically, what these new areas could be was never properly discussed. But it transpired from the discussions that a prime candidate for "flexibility" could be the whole area of Economic and Monetary Union, inolving the future building of common policies in the spheres of fiscal policy and social policy.

One reflection of this trend was the debate in the autumn of 1997 about whether or not the Luxembourg European Council should sanction a French proposal to set up a new, informal, council, comprising only Finance Ministers belonging to the single-currency area. The professed objective of this proposal was the creation of a forum enabling ministers to discuss matters relating to the implementation of the common monetary policy, matters which at first sight did not concern those outside the euro-zone.

However, the French Finance Minister, in a detailed article in the *Financial Times* (27 November 1997), suggested that this smaller group of Finance Ministers ought to meet in order to address a much wider agenda, including the closer coordination of national fiscal policy, as well as coordination in the areas of growth and employment, thereby also partly acting as a counterweight to the European Central Bank. According to the treaties, however, these matters all lie at the heart of the Ecofin Council's agenda; in other words, all member states should take part in the debate, under the usual procedures.

In the event, the Luxembourg Summit did authorize the establishment of this closed forum, but restricted its remit to *"issues connected with [the "ins'"] shared specific responsibilities for the single currency"*[1]. This wording supposedly precluded issues which are conventionally considered of common interest (certainly, fiscal coordination, growth and employment). Formal decisions, in any case, can only be taken by the Ecofin Council, in which all member states participate.

Nonetheless, it remains a fact that, if the eleven single-currency countries decided on a certain course inside this informal caucus prior to an Ecofin meeting, the four "outs", not having a blocking minority in the Council, would simply have to acquiesce, without having participated in the preparatory discussions.

It may be that monetary union will not create great divisions between the "ins" and the "outs"; but not belonging to the euro-zone group of countries certainly carries with it certain non-negligible institutional and political risks.

The potential dangers of a two-track Europe will, of course recede, from Greece's point of view, if Greece succeeds in joining EMU on 1 January 2001, as is the

[1] See the Presidency Conclusions.

Government's announced goal. It has promised that by the end of 1998 the budget deficit will be below 3%, from 4.2% at the end of 1997, and that the downward trend of public debt will be consolidated. In 1997 public debt stood at 119.3% of GDP, down from 120.2% in 1996. Inflation, at 4.5%, is at its lowest level in twenty-six years, and is expected to fall to 2.5% by the end of the year, which is within the Maastricht requirements. The fact that GDP growth presently is, at 3.5%, higher than the EU average should also facilitate the achievement of the Maastricht criteria[1].

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[1] Various press sources.

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