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The Greek Tragedy: An Enquary into the Financial Crisis of Greece

Abstract

The Greek Government debt crisis (also known as the Greek depression) started in late 2009. Greece is the first developed country to fail to make an IMF loan repayment. On June 2015.This crisis destroyed one quarter of the GDP of the economy and has led more than a quarter of labor force to unemployment, in a period of five years. This economic crisis in Greece spilled over to other European countries including Ireland, Portugal and Cyprus very soon. The case study provides the deeper knowledge about the causes, results and probable solutions for The Greek financial crisis.

Keywords: Greece, Crisis, Government, Depression, IMF, European, GDP, Debt.

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Introduction

The 2001 introduction of the euro as a common currency reduced trade cost among the euro zone countries, increasing the trade volume, however labor cost increased more in peripheral countries(like Greece) relative to core countries (like Germany). This made Greek export less competitive in the world market. Greece saw its current account deficit rising significantly.As the Greek depression that began in the US in2007-09 spread to Europe and the flow of fund from European core countries to Greece began to dry up. In 2009 Greek fiscal management and deception increased borrowing cost that only means that Greece could no longer borrow to finance its trade and budget deficit.A country facing sudden stop in private investment and a high debt load typically opts for currency depreciation to encourage investment and to repay loans. But this was not an option for Greece while remaining on the euro. In the meantime to become more competitive Greek wages fail nearly 20% in mid 2010-14. This resulted in significant decline in income and GDP which however led to a severe recession. Syriza is not traditional left wing party of Greece; it is a different, further left party's rose to power by displacing the traditional Greek social democrats. In present day Europe, Greece is the only country whose coalition government led by a far left party. What began as a debt crisis in Greece in late 2009 has evolved into a broader political crisis. Current prime minister, Alexis Tsipras was elected in late January 2015 following a campaign in which his far left anti-establishment Syriza party pledged to remain in the euro zone. In late June, Tsipras called a surprise referendum asking voters to decide whether its government should accept the creditor's terms. Greece voted overwhelmingly to reject the terms.

There are several causes responsible for this crisis, like huge fiscal deficit in the years 2004-09, government debt, poor budget compliance, tax evasion and subsidies, misreported debt statistics. In 2004, Athens was the host of Olympics and its expenses for this were seven times of previous Sydney Olympics in 2000. This increased government debt as well.

The Greek crisis had severe adverse effect on socio-economic changes. Greek GDP suffered its worst decline in 2011 when it reached (-) 6.9%, 111000 Greek companies went bankrupt. In February 2012 it was reported that 20000 Greek had been made homeless during the preceding year. By 2015 unemployment of Greece had reached 26%, nearly 20% of Greek lacked sufficient funds to meet daily food expenses. In October 2011, minister of finance, Yanis Varoufakis, announced that the Government would establish a new fund, aimed at helping those who were hit the hardest from the government austerity measures. The money for the agencies would come from crack down on tax evasion.

However there were several solutions discussed to get rid of this crisis like exit the euro zone, introduce Digital currency card, negotiate another bail out and arrange European Debt Conference. Though none of these have proved to be fruitful yet. The austerity measures helped Greece

Country	Year	Causes
Australia	1930	Late 1920's profit issues in agriculture and cut backs
	1990	Major stock collapse in 1987 October referred to now as Black Monday
United Kingdom	1917	Oil price shock
	1919-1921 (end of World War I)	World War I
	1930	US Great Depression
	2008-2009	Rising global commodity prices, subprime mortgage crisis infiltrating the British banking sector, significant credit crunch
United States	1918-1921	World War I
	1929-1933	Great Depression
	2007-2009	Subprime mortgage crisis

bring down its primary deficit from 25 billion Euros in 2009 to 5 billion Euros in 2011 but as a side effect this also contributed to worsening of the Greek recession. IMF extended two financial assistance packages to the Greek government in the year 2010 and 2012. The Greek government and its European and IMF creditors had been intense negotiations for month over the final disbursement funds from the second financial package. The European central banks initiated series of policy measures including providing liquidity support to euro zone banks and purchasing government bonds in secondary markets.

Aim of the Study

To look for the causes and solutions of the economic downfall of Greece in 2011-12.

Problem

The focus of this paper is on the Greek economic crisis, its causes and probable solutions. Greek economy was never strong enough to share a currency with Germany but both sides pretended it was, as it satisfied Greek pride and Germany's ambitions of building an 'Ever Closer Union' in a new democratic Europe. Reckless lending by French and German banks allowed the Greek to finance widening budget and current account deficits for six years, but private capital flows dried up sharply after the 2008 crisis, forcing Greece to seek help from Euro zone governments and the IMF in 2008 leading to a severe fiscal debt crisis.

Analysis and Findings

What Is Recession

Economic recession is a period of general economic decline and is typically accompanied by a drop in general demand and the stock market, an increase in unemployment and a decline in the housing market. Generally a recession is less severe than a depression. The blame for a recession generally falls on the federal leadership, often either the president himself, the head of the Federal Reserve, or the entire administration. There can be several causes for recession like high interest rate, inflation, reduced consumer confidence, reduced real wage.

Previous Recessions

Many other countries particularly in Europe had undergone decreasing rates of GDP growth. Some countries have been able to avoid a recession but have still experienced slower economic activities. China, India and Australia were able to maintain positive growth throughout the recession in 2000. China had experienced stock market crash which began with the popping of the stock market bubble in 2015. Canada officially declared a recession in 2015 after 2 quarters of shrinking GDP.

Political Situation in Greece

Since 1974 Greece has been ruled by two political parties – Pasok (the social democrats) and New Democracy (conservatives). They have shared alternating periods of government as well as being in coalition during the latest crisis. In the wake of a deteriorating public balance sheet, successive Greek governments accepted the politics of austerity demanded by an international troika (EU, European Central Bank and IMF) as a way of gaining access to loans. The conditions for these loans are codified through a series of evolving memoranda imposing increasingly strict and detailed directives for the social and economic policies of Greek governments. The troika imposed memoranda provide the basic fault line that defines Greek politics.

The established political game unraveled as it was revealed that successive Pasok and New Democracy governments had lied about the true nature of public accounts. A bailout package was designed, requiring Greece to enter a death spiral of harsh austerity measures to be monitored and evaluated by troika.

The Greek political landscape changed dramatically in 2012 with the electoral success of Greek Radical Left Coalition (Syriza) that campaign explicitly on rejecting policies of economic austerity. Syriza garnered 27% of the votes and went on to be first party. The intensity of the economic crisis and unrelenting austerity policies fueled political tension with several elections and re-election by Prime Minister, AlexisTsipras

Causes of Greek Crisis

GDP Growth Rates

After 2008, GDP growth rates were lower than the Greek national statistical agency had anticipated. In the report, the Greek Ministry of Finance reported the need to improve competitiveness by reducing bureaucracy, and the need to redirect much of its current governmental spending from non-growth sectors such as military into growth-stimulating sectors.

The Government's Deficit

Huge fiscal imbalances developed during the five years from 2004 to 2009. The output increased in nominal terms by 40%, while central government primary expenditures increased by 87% against an increase of only 31% in tax revenues

Government's Debt-Level

Mainly deteriorated in 2009 due to the higher than expected government deficit and high debt-

service costs, an urgent fiscal consolidation plan was needed to ensure that the deficit would decline to a level compatible with a declining debt-to-GDP ratio. There was an urgent need in the coming four-year period to implement packages of both permanent and temporary austerity measures. Implementation of this entire package of structural reforms and austerity measures, in combination with an expected return of positive economic growth in 2011, resulted in the baseline deficit only €5.7 billion in 2013. The debt-level relative to GDP stabilizedin 2010–2011 and begin declining again in 2012 and 2013.

Budget Compliance

Budget compliance was acknowledged to be in strong need of improvement, and for 2009 it was even found to be a lot worse than normal, due to economic control being more lax in a year with political elections.

Statistical Credibility

Problems with unreliable data had existed ever since Greece applied for membership of the Euro in 1999. In the five years from 2005 to 2009,Eurostat each year noted a reservation about the fiscal statistics for Greece, and too often previously reported figures got revised to a somewhat worse figure, after a couple of years. The flawed statistics made it impossible to predict accurate numbers for GDP growth, budget deficit and the public debt. By the end of the year, all turned out to be worse than originally anticipated. Problems with statistical credibility were also evident in several other countries, but in the case of Greece, the magnitude of the 2009 revisions and its connection to the crisis added pressure to the need for immediate improvement.

Government Spending

The Greek economy was one of the fastest growing in the Euro zone from 2000 to 2007: during this period it grew at an annual rate of 4.2%, as foreign capital flooded into the country. This capital inflow coincided with a higher budget deficit. After the removal of the right-wing military junta in 1974, Greek government wanted to bring disenfranchised left-leaning portions of the population into the economic mainstream] and so ran large deficits to finance enormous military expenditure, public sector jobs, pensions and other social benefits. Greece was, as a percentage of GDP, the second-biggest defense spender in NATO, the highest being the United States, according to NATO statistics.The long period of budget deficits caused a situation where, from 1993, the debt-to-GDP ratio was always above 94%. In the turmoil of the global financial crisis, the situation became unsustainable (causing the capital markets to freeze in April 2010), as the downturn had caused the debt level to grow rapidly above the maximum sustainable level for Greece. Prior to the introduction of the euro, currency devaluation helped to finance Greek government borrowing. After the euro's introduction in January 2001, the devaluation tool disappeared. Throughout the next 8 years, Greece was able to continue its high level of borrowing because of the lower interest rates that government bonds in Euros could command, in combination with a long series of strong GDP growth rates. Problems started to occur when the global financial crisis peaked, with negative repercussions hitting all national economies in September 2008. The global financial crisis had a particularly large negative impact on GDP growth rates in Greece. Two of the country's largest earners, tourism and shipping were badly affected by the downturn, with revenues falling 15% in 2009.

Current Account Balance

The translation of trade deficits to budget deficits works through sectoral balances. Greece ran current account (trade) deficits averaging 9.1% GDP from 2000–2011. Greece's large budget deficit was funded by running a large foreign financial surplus. As the inflow of money stopped during the crisis, reducing the foreign financial surplus, Greece was forced to reduce its budget deficit substantially. Countries facing such a sudden reversal in capital flows typically devalue their currencies to resume the inflow of capital; however, Greece was unable to do this, and so has instead suffered significant income (GDP) reduction, another form of devaluation.

Tax Evasion

Another persistent problem Greece has suffered in recent decades is the government's tax income. Each year it has been below the expected level. In 2010, the estimated tax evasion costs for the Greek government amounted to well over$20 billion.As of 2012, tax evasion was widespread, and according to Transparency International's Corruption Perception Index, Greece, with a score of 36/100, ranked as the most corrupt country in the EU. One of the conditions of the bailout was implementation of an anti-corruption strategy. The Greek government agreed to combat corruption, and the corruption perception level improved to a score of 43/100 in 2014, which was still the lowest in the EU, but now on par with Italy, Bulgaria and Romania.

Misreported Debt Statistics

In early 2010, economy commissioner Olli Rehn denied that other countries would need a bailout. He said that Greece has had particularly precarious debt dynamics and Greece is the only member state that cheated with its statistics for years and years. It was revealed that Goldman Sachs and other banks had helped the Greek government to hide its debts. Other sources said that similar agreements were concluded in Greece, Italy, and possibly elsewhere. The deal with Greece was "extremely profitable" for Goldman.To keep within the monetary union guidelines, the government of Greece had also for many years is reported the country's official economic statistics. At the beginning of 2010, it was discovered that Greece had paid Goldman Sachs and other banks hundreds of millions of dollars in fees since 2001, for arranging transactions that hid the actual level of borrowing. Most notable is a cross currency swap, where billion worth of Greek debts and loans were converted into yen and dollars at a fictitious exchange rate by Goldman Sachs, thus hiding the true extent of Greek loans.The purpose of these deals made by several successive Greek governments was to enable them to continue

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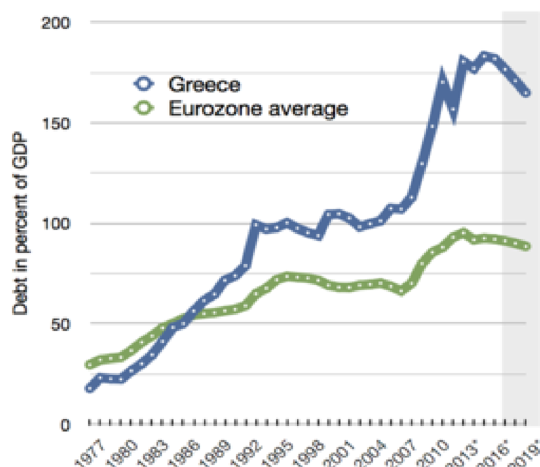
spending, while hiding the actual deficit from the EU, which, at the time, was a common practice amongst many European governments.[] The revised statistics revealed that Greece at all years from 2000 to 2010 had exceeded the Euro zone stability criteria, with the yearly deficits exceeding the recommended maximum limit at 3.0% of GDP, and with the debt level significantly above the recommended limit of 60% of GDP.

Debt levels revealed:



Source: Eurostat, Ernst & Young

In the above figure debt percentage of Greece is compared to the average of the euro zone since 1977. On the horizontal axis the debt in percentage of GDP is measured whereas on the vertical axis respective years are shown.In February 2010, the new government of George Papandreou (elected in October 2009) admitted a flawed statistical procedure previously had existed, before the new government had been elected, and revised the 2009 deficit from a previously estimated 6%–8% to an alarming 12.7% of GDP. In April 2010, the reported 2009 deficit was further increased to 13.6%,and the final revised calculation, using Euro stat's standardized method, set it at 15.7% of GDP; the highest deficit for any EU country in EU.

Countries Affected

With growing unemployment and staggering economy, Greece had been experiencing an economic crisis since the 2008 meltdown and the journey had always been downwards. With debt crisis beginning in 2010, international banks and financial investors had pulled out their Greek bonds and other holdings, rendering them insulated from the Greek economic changes. Private investors, who did not pull back, however had hard times ahead. The other countries in the euro zone Portugal, Ireland and Spain who were debt ridden had taken steps to stable their economy and are less vulnerable now. Due to Greek crisis there was some pressure on the other euro zone countries. This was because the vulnerable members such as Portugal, Spain or Italy signaled that they might also pull out from the euro zone. Moreover some European company share prices also fell sharply due to investors' panic and diverted their cash into government bonds of Germany or Finland. The dilemma lied in the severity of this financial crisis.However according to the Bank of England, there had been no sign so far that the crisis was spreading to other vulnerable nations in Europe such as Spain and Portugal, let alone to stable countries like UK.

The IMF and Greek Crisis

The IMF decided not to sign off on the European Union's bail out deal with Greece, saying it does not specifically address tackling Greek debt. The IMF said that they could only come to this decision during a stage round of negotiations in which Greece had agreed on a comprehensive act of reforms and more importantly after creditors had agreed on debt relief, Berlin and other European creditors had refused to grant Greek debt relief which prolonged IMF's lack for the deal. Under IMF bailout criteria the recipient must be able to prove that it had the institutional and political capacity to implement the required economic reforms.

In case of Greece IMF had deemed that neither criterion had been made. Greek Prime Minister, Alexix Tsipras, faced the wave of international criticism from and within his Syriza party for ageing to the bailout package which would involve Greece having to impose the number of austerity measures. Athens had pushed aggressively for creditors to write down the countries debt which exceeded 300 hundred billion Euros. Without it Prime Minister Tsipras had argued that the debt would remain a heavy weight on Greek troubled economy. Once the Fund proposed that creditors let Athens write off part of its huge euro zone debt or at least make no payment for 30 years. Hence the IMF was making **a** tactical move adding pressure to the negotiations over the bailout deal but its aggressive positions also complicated efforts to complete a deal, with Greek parliament scheduled to vote whether to accept the creditors' conditions as the uncertainty over the deal mounted up Greek's rapid growing financial needs only created additional strains on the euro zone, while its unity was already shaken. With Greek's banks closed and foreign investment at the standstill the economy was sinking fast, under cutting tax revenue and making it even harder for the government to pay its debt. Greece would need to spend a sum equal to more than 15% of GDP, annually to pay interest and principal on its debt. And that, in the Fund's view is an unbearable burden.

Present Scenerio

After several months of negotiations between the country and its creditors Greece receives its third bailout in five years.Terms of the bailout including commitments by the country to implement austerity measures and economic measures which Greek law makers recently approved. The legislation covered some the economic changes sought by the country's international creditors which includes raising the retirement age, cutting pension, liberating the energy market, opening up cosseted professionals, expanding the property tax that Greeks already revile and pursuing forward a stalled programme to privatize state assets. Passing that package paved the way for Greece to receive two billion Euros from

the bailout programme. But international bailout programme of Greece has hit snags even before the first euro of loan payout has been dispensed.

Future Condition

There is a big chance of Grexit in future. In that case Francs, Lira and Deutchse marks could make a comeback. Some economists think that Greece pulling out of the euro zone would spell the end of the single currency. Even without a complete breakdown of the euro, Greek exit will leave the European Central Bank holding billions of dollars of Greek debt and fewer options. The longer it takes time, the more fear mounts that a Greek exit will send Europeans rushing to banks to withdraw their savings. The fragile euro zone has already been facing declining consumer prices and news of a Greek exit will lead to liquidate their European assets. Further more if Greece exits the euro zone investors will begin to view the weaker European countries like Cyprus, Ireland, Portugal, Spain and possibly Italy as risks. As the fallout from the crisis spreads to the EU, onlookers fear that it won't stop there. A slowdown in Europe could lead to further shocks to the world market and can damage global exports.

Policy Prescriptions

Exit the Eurozone or Grexit

The Greek economy can recover from the severe recession by exiting the euro zone (or Grexit) and launching a new national currency Drachma. The devaluation of the currency may help Greece boost its exports and pay down its debts with cheaper currency. However the consequences of Grexit could be global and severe including –Membership in the euro zone would no longer be perceived as irrevocable. Other countries might be tempted to exit or demand additional debt relief. These countries might also see the interest rate rise on their bonds, making debt service more difficult.Further depreciation of the euro relative to the dollar, would cheapen euro zone exports while making more expensive for euro zone members. This could reduce the exports of non-euro countries. Hence exit the euro zone would not be a good option for Greece.

Digital Currency Cards

The bank multiplier effect means the amount of bank deposits far exceeds the amount of paper Euros. Greece and its people face a shortage of paper Euros when withdrawing funds from their bank accounts. Reducing the requirement of paper Euros in the withdrawal process into a digital form allows withdrawals and spending. Hence Greece needs to encourage the use of digital currency cards

Negotiate another Bailout

Greece could also agree to additional bailout funds and debt relief in exchange for further public pension cuts, privatizing certain government owned businesses, selling government owned assets, raising tax rates and more aggressively collecting taxes. However the present austerity strategy has contributed to Greek depression, making it even harder to pay back its debts, so it is not clear how further austerity measures if not accompanied by very significant reduction in the debt balance owed.

European Debt Conference

A conference on all of European's debts, just like World War II is really needed. A reconstruction of all debt, not just in Greece, but in several European countries is inevitable.

Conclusion and Suggestions

The Greek debt crisis is more than whether the small country defaults on its debt or exit the euro zone. The Greek crisis warns of the danger facing other heavily indebted countries. EU leaders have struggled for six years to agree on its resolution. During this time, crisis triggered the euro one debt crisis, created fears of a global financial crisis, and still throws into question the viability of the euro zone itself. In 2009 Greece kicked off the crisis by admitting its budget deficit would be 12.9% of GDP. That is more than four times the EUs 3% limit. Unfortunately it also drove up the cost of future loans, making it more unlikely that Greece could find the funds to repay its sovereign debt. In 2010 Greece announced an austerity package that would lower the deficit to 3% of GDP in two years. It was designed to reassure the agencies it was fiscally responsible. Just four months later Greece warned it might default anyway. The EU and the IMF provided 240 billion Euros in emergency fund in return for even more austerity measures. That only gave enough money to pay interest on its existing debt and keep bank capitalized and barely running. Unfortunately measures further slowed the economy, reducing the tax revenues, needed to repay the debt. Unemployment rose to 25%, riot erupted in the streets and the political system was in a crisis as voters turned to anyone who promised a painless way-out. Through a referendum Greek government had decided not to agree with the austerity package given by IMF and its European counter parts. Hence Greece had thought of some policy implications to fight the crisis. The probable solutions are exit the euro zone or negotiate over the bailout package with the IMF.

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