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Reasons of Greek Debt Crisis and How it was Handled during the Period (2009-2018)

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ABSTRACT

The problem of the study confined to analyze the roots of the Greek debt crisis and the major deficiencies in the Greek economy and the actions taken by the Greek authorities and EU institutions to handle the crisis In this paper the Greek debt crisis was analyzed, explaining the factors that led to the outburst of the crisis, showing how the financial market lost confidence in the Greek economy so borrowing from financial market became impossible. Long negotiations took place before the troika approved bailing out Greece .Three bailout packages were approved but was accompanied with severe austerity measures and strong haircut to private bonds for the first time in history to be done by developed economy. The study aims to identify how the Greek debt crisis outbroke and how Greece fulfilled the accession criteria to enter the Eurozone despite of the major deficiencies embodied to the Greek economy .And to identify the action taken by Greek government to handle the crisisLesson learned from the study that countries should not engage in excessive borrowing unless to develop its economy and create competitive advantage to adopt export growth approach and countries should not create monetary union unless they fulfilled the criteria of optimal currency area finally the EU surveillance mechanism must be enhanced.

INTRODUCTION

The weak economic position of Greece started to appear clearly in its relation with other EU countries from the beginning. It may be small incident but it has significant implication. When negotiating the format of the euro note Greece finance minister argued that notes should have Greek letter on it not just Latin the response of the German Finance Minister was in aggressive and a snobbish way “poor, small, semi agricultures Greece is on no position to start making demands about the kind of money that should be circulated in mighty industrial power such as France and Germany” actually even if it wasn't an elegant way but it was fair point this how core countries perceived Greece and this actually how it was. In reality Greece economy wasn't very healthy more over there was no signal that it was on the right track to compete with German and French industry. Greece never managed to go on the right track. At the times the rest of Europe was rapidly modernized Greece was hurting in the other direction.

Actually, Greece was the catalyst of the outbreak of the crisis as it has the worst combination of budget deficit and current account deficit (deficit of competitiveness). Official figures showed that in eight out of nine years between 2001 and 2008 the government budget deficit exceeded the 3% laid down is SGP (noting that figures were a1ready not accurate) (lynn,2011, p115).

So we are going first to explain the major distortion in the Greek economy and how it became in desperate need for bailout, second we are going to show how negotiation took place before approving bailout packages and touch action accompanied to the approved packages.

Objective of the research

Analyze the roots of the Greek debt crisis and how the major deficiencies of the Greek economy were not clear by answering the following question

1- What are the major deficiencies in the Greek economy?
2- How did Greece fulfil the accession criteria of the EURO?
3- How Greece faced the lack of confidence in the financial market to its economy?

Research Methodology:

Quantitative analysis methodology and post-positivist knowledge claim as data about the debt, deficit and bailout package will be collected and analyzed.

Research Hypothesis:

1- Greece was not qualified to join the Euro
2- Aggressive actions will be taken from EU
3- Greece cannot handle the crisis by its own

First: Major Deficiencies in Greek Economy led to debt crisis

Greece main economic distortion is budget deficit the bulk of that deficit is structural. It reflected permanent gap between government expenditures and taxes. Greece witnessed a decade of public sector spending boom started from 1980's as there was an intention to buy what was called social peace the pension system was a big problem some retirees were earning more than they worked. Greek pensioners on average earn 96% of the salary they had when they worked (Manolopoulos, 2011, p8).The retirement age was 58 far below the average of EU countries Greek pension calculated on last year of their working life. Female civil servants with children under 18 can still get early retirement.

Greek government were spending in a really irrational way that didn’t suit their economic situation at all. Clear example was the modem Olympics. Greece was by far the smallest and poorest country to host the games. However, it spent $ 15 billion as a total bill for hosting the game.

On the other side Greek economy had become a massive exercise of tax evasion. True it was dishonesty from Greek citizens but strong administration in any uncorrupted country never depends on the honesty of its citizens .In reality it was weak and corrupted administrative capacity not paying your taxes had become a way of life for middle class Greeks which represents large proportion of the Greek economy which has the highest percentage of self employed in the OECD dominated by small, family run enterprises. In 2009 the year when the financial crisis outbroke according to federation of Greek industries government was losing $ 30 billion through tax evasion and according to transparency international data 900 million euro was paid out in bribes (Lynn, 2011, pp117-122).According to OECD in 2011 if Greece had tax collecting capacity of average member of the organization its tax revenues would had increased by almost 5% of GDP (Tsoukalis,2012,p29).

The question here how could the Greek government fill this gap between its excessive public spending and its weak resources?

The answer found in the easy money offered to the Greek government after joining the euro. Greece after joining the euro was categorized as developed country. It found itself suddenly backed by strong currency with low interest rate set by the European central bank (ECB). So that it could borrow as much money as it wanted as suddenly Greek debt became demanded. Yield to Greek debt bonds fell, spread between Greek bond and German bunds narrowed to 55 points. Which means that Greece could borrow money at rate just 0.5% higher than Germany (Lynn, 2011, p.53).

The problem wasn't just the trend of borrowing many developing countries are taking the same trend but they borrow in order to build strong economy, great moderation, specialized industry so borrowing sound safe. This wasn't the case of Greece. Greek debt was described as an odious debt. Because it wasn't spent on economic development rather it was spent on consumption over the country's capacity so it came on the expense of future generations. Although Greece enjoyed a lucky period of economic growth in the early 2000's but the Greek economy was significantly reliant on tourism, shipping, agriculture and later on real estate, there wasn't sufficient investment in other sectors. Finally, economic indicators do not always tell the truth high growth rate doesn't always mean strong economy, but it may hide very fragile economy.

Expected consequence of the combination of weak supply side and increased demand side because of the excessive government spending is current account deficit (gov. spending increased, salaries increased, consumer spending increased) with no strong industry so the solution is imports.

It may appear surprising for example that sales of Luxurious vehicles doubled within the first five years of joining the Euro, given that Greece has no domestic car industry, this was direct hit on the current account, as such luxurious cars do not increase the future productivity of country nor its ability to generate cash flow to payback borrowed money, so it just put burden on the country's current account. The case applied on many luxurious goods on the other side Greece never worked on industrializing its economy its main exports are low value-added products. Its exports have mainly 3 classifications of goods light petroleum, medical supply and fish total exports represents on average 7% of Greece GDP.

Greek was stuck between high tech countries like France and Germany and low wage countries like Bulgaria and Romania. It failed to find competitive advantage un modernized industry and high labor wages due to strong labor union, wages average higher than that of Germany itself so the obvious result was current account deficit.

If the case is that worse and Greece suffered from such weak economy with such structural deformation, how did Greece fulfill the accession criteria and joined the Euro zone?

Actually, Greece in 1999 didn't meet the criteria. Budget deficit during 1990's was 16% of GDP and debt was more than 100%, inflation was always two digits figures so Greece failed by far. Between 1999-2001 something weird happened Greece suddenly fulfilled the criteria except public debt was still over 100% but without increasing trend and below that of both Italy and Belgium. In 2001 Greece formally joined the Euro.

In 2004 European commission announced that it has gone back over the figures supplied by Greece when decision was made to allow the country into the Euro and found what was described as significant accounting error. In reality Greece had never been qualified for the single currency, in 2009 George Papandreou announced that Greece budget deficit was going to be much bigger than previously claimed by the previous governments. Figures wasn't around 6% but it was over 12%. In 2010 as Greek's crisis broke it turned out to be scandal in the financial market when it was discovered that one of USA biggest investment banks global Sach had used series of swap arrangements that helped to hide the amount of money Greek government was actually borrowing. These arrangements according to head of Goldman Sachs are legitimate. But actually, it led to creating additional credit to Greek governments with higher interest rate. The idea that the arrangement involved cross - country swaps linked to Greece's outstanding yen and dollar debt. A weaker level of euro versus dollar and yen was used, resulting in an upfront payment to Greek government but subsequent higher interest rate (Manopoulos, 2011, pp.24-57)

Second: Greece and the International Community reaction towards the Crisis:

Greece as mentioned before in this study was in the worst situation among the indebted countries. The fact that Greece became on the edge of leaving The European union or may announce its default puts an extraordinary burden on Greek leaders to handle the crisis with firm actions even if it has social cost. As Greek debt/GDP reached 127% in 2009 and the financial market totally lost confidence in the Greek economy so borrowing from financial market became no longer an option.

Greece strategy to handle the crisis was based on three pillars

1- Bailout packages
2- Austerity measures
3- Structural reform.

1- Bailout packages

The option of bailout was totally refused at the beginning of the crisis from all stake holders. German the largest EU country was very reluctant to go through that option. As German economy used to be very stable managed by clear policies. German constitution court before approving Maastricht treaty emphasized that the new Euro currency will be launched in a regime of monetary stability. The clause of "No bailout" was very important to German negotiator while discussing Maastricht treaty. German Leaders in the new era became more concerned about their national interest. The stigma of being guilty after WWII was no longer represents any concern to German's decision makers. Germany itself had gone through sustained austerity for two decades. So, it seems unacceptable for German people to bear the cost of undisciplined state. The opposition was not from Germany only apart from the legal framework of Euro zone that prohibits bailing out. Many Euro Zone members are themselves experiencing financial difficulties. So, they weren't convinced with the idea of helping country that didn't manage to exercise budget discipline. Moreover, they found that this will be message to the rest of the countries that it is okay to run up massive debt then cheat and we are going to pay back your bill.

Despite of the mentioned strong opposition, the case in Greece was getting worse in 2010.The country's borrowing requirement was higher in the same time financial market lost confidence in the Greek economy it became clear that the self-commitment of the Greek government to reduce deficit by 4% in 2010 is impossible.

Under these conditions external help became necessary on April 2010 Greek Prime Minister George Papandreou announced the Greek need of Bail-out.

The question here became who will give hand Greek prime Minister started to make noises that he is looking for help from the IMF.

Many EU officials were insisting that Euro Zone must take care of its own problem to preserve its strength and credibility, especially that the Euro was first introduced to the Financial market as alternative to dollar and European leaders had been always emphasizing how EU generally became economic giant. IMF intervention was perceived by many humiliations for the Euro Zone. IMF was perceived as refuge for failed states, developed countries are not used to be seen there.

Euro area leaders found themselves obliged to give hand. The debate became whether IMF will interfere or Euro-Zone will handle its own crisis.German Chancellor Angela Merkel was pro-calling in IMF, although she saw the idea might be humiliating but it has several advantages.

First and Most important calling in IMF will preserve no-bail out clause, although it was turning around the rule but it may seem acceptable for tax payers. As world's most developed nations are member in IMF. So, the idea here will be interpreted that the whole world is helping indebted countries not Euro members are bailing out indebted members.

Second hard measures will be requested from Greek government ,cuts in public spending, lost jobs, wages will be reduced and retirement ages will be raised those tough measures will not be popular so it's better to divert the public anger of the Greek towards IMF not European union.

Last IMF as an institution had the qualified people and the experience to handle such situation EU countries and institutions do not have such expertise (Lynn, 2011,143-144).

Finally, on 2 May 2010 European commission, ECB and IMF (troika) agreed on 3 years program loan for Greece amounted 110 billion Euro (145 Billion USD) conditional on implementation of austerity measures and structural reform.EU share was $ 105 Billion and IMF share way $ 40 billion. It goes without saying that Germany bore the largest percentage of the EU share which was 29.3% then France 22%, percentage borne by Italy and Spain was Italy 19.3% and Spain 12.8% Although they are themselves have financial problems (Nelson, Belkin, Mix,2010, pp10-11).

EU leaders found themselves in a position that formulating mechanism for providing financial assistance to Greece is very essential. There were three main mechanisms to formalize financial assistance to indebted countries first launch of the European stabilization mechanism under this scheme European commission is allowed to raise up to 60 Billion Euros on the money market at low interest rate by issuing bond using the EU's annual budget as collateral, then it can lend EU states that are highly indebted. This mechanism could be activated without the approvals of the parliaments. Second in case of running out 60 billion other mechanisms will be activated European financial stabilization facility (EFSF). This would have up to 440 BN Euros available to EU members, under this mechanism the EU established a so-called special purpose vehicle that can issue bond and then forward the money as loan to indebted countries. IMF committed an additional 250 BN Euros to total package. Those bonds are guaranteed individually by 16 member states based on their share in ECB. Third was European central bank (ECB) intervention by creating the securities market program under which it can buy any private or public securities in secondary market as EU treaty explicitly prohibits the ECB from buying government debt directly. During the first 6 months of the SMP the ECB bought around 70 BN Euros (Lapavitsas *et al*, 2012, pp108-110).

Returning back to Greece it received the first financial assistance according to the approved three years package 110 BN Euros in 2010 it consisted of EU loan of 30 BN and IMF loan of 15 BN Euros. Actually, the approved fund was not for free but it was granted with interest rate 5.2%.

The approved financial bailout was conditioned by applying strict plan to reduce budget deficit through increase VAT from 19% to 21% increase taxes on fuel, cigarettes, alcohol and luxury goods, increase wages' tax, public sector salaries' increase to be frozen and reforming pension and taxes system (Todorovic, Bogdanovic,2011, p.169).

A year later on 2011 due to recession and weak implementation of the agreed conditions by Greek government the case became worse as the condition forced a second bailout worth 130 BN Euros. This included a bank recapitalization package with 48 BN Euro.

However, the second bailout was conditioned by private sector involvement. Negotiations were held on February 2012 by Euro area heads and steering group of 12 banks, insurer and asset management on behalf of larger group of 32 creditors holding around 40% of Greece privately held debt (Trebesch, Zettlmyer,2013, P.9)

Relief plan was agreed accordingly investors forgave 53.5% of their owed bonds and the remaining amount was exchanged with new bond amounted 31.5% of the principal with maturity of 11 to 30 years and low coupon and two-year notes issued by EFSF amounted 15% of the principal. The result was debt relief equivalent to half of Greece's 2011 GDP (Porzecanski, 2012, P.8)

Actually, it was historical event for two reasons; the amount defaulted was very huge 200 Bn Euros and for the first time advanced European country to announce such debt restructuring. It was perceived as voluntary restructuring by bond holders, however in reality they had no choice a clear message was sent by Greek authority that funds are not sufficient to make payment for private sector. On 2012 the troika provided Greece with more debt relief.

On 2014 although there was signal for improvement in the Greek economy, the new elected Sgriza Government rejected the existing bail out terms thus the troika suspended all scheduled remaining aid to Greece which caused liquidity problem in Greece.

On January 2015 the troika granted four-month extension of its bailout program, however, on July 2015 referendum was done and bailout terms were rejected by majority 61% at the same time Euro zone leader's proposal of third bailout program is conditioned by the same terms, subsequently the case is becoming worse.

Despite July referendum, pressure was very strong on Greek government as Greece missed major due payment and Greek banks closed. So Greek parliament approved new reform plan in exchange of third package amounted 86 Bn Euros from EU as IMF rejected to participate. The amount approved to be disbursed by 2018 (Council on foreign relation, 2019).On 20 August 2018 Greece officially ended ESM program after 8 year of receiving loans from troika with total amount 289 Bn Euros. Despite the fact that the program helped Greece to take steps towards reforming its economy and adopting more disciplined fiscal policy but the cost borne by Greek people was tough in the form of several Austerity measures.

2- Austerity

Austerity measures always sound bad to the public it is the actual meaning of declining in living standard. Greek people used to live luxurious life beyond the financial capability of the country. So, imposing such painful measures was practically beyond the ability of the government to tolerate the Greek street. But actually, it was not an option Greek government didn't have the choice. Greek prime minister announced it clearly that such measures are under order from foreign power (IMF and European Union). German chancellor played important role in making the prerequisite conditions for the loan tougher. Maybe this was factor that deepened the public opposition to such measures.

At the end Austerity measures were announced by law as memorandum was signed by Greek Government, EU and IMF passed by the Greek parliament. Thus, has the force of law it entailed very ambitious saving program in addition to explicit clause allows the government to make whatever action it found necessary to maintain fiscal stability (Lapavitsas *el al*, 2012, p.119).

The fiscal austerity plan centered on both sides deep cut to public spending in addition to enhance revenue growth.

On the spending side the following actions were taken,Decrease labor privileges starting with the public sector which was the main sector accused of causing such significant debt. Greek employees as discussed before were enjoying privileges that didn't match their productivity at all. So significant cut has been imposed on their wages what was so called 13th and 14th salaries as bonus was replaced by annual lump sum varies with the wage. More over wages were frozen, employment in public sector was reduced on one-for-five basis as every 5 workers retired were replaced by hiring one worker. The government liberalized the so called. "Closed-shop professions including 70 profession enjoying anti-competitive regulations". On the private sector side 13th and 14th salaries remained however no raises that match the inflation. Companies with employees between 20 up to 150 were allowed to dismiss up to 6 employees per month and companies above 150 employees were allowed to fire up to 30 employees per month. Termination period requested to inform the employee was reduced from 24 months to only 2 months in addition employees less than 25 years old and employed for the first time could be paid less than the minimum payment allowed. Drastic changes happened concerning pension and retirement policy Greece like most of Europe has aging problem it has 2.6 million pension receivers and 4.4 Million workers. Taking it into consideration that Greece scores very low in global productivity scale and it is among the highest OECD countries regarding compensation for public employees so pension reform become necessary so 13 and 14 pensions were cut for those who are receiving more than 2500 Euro per month and for all pensioners less than 60 years.Pension way of calculation also changed as the calculation became based on the average of the entire working period instead of the last five years of work, as Greek pensioner were used to have up to 96% of their last income it became not allowed to take more than 65% of the last income. No workers were allowed to retire at age less than 60 and full pension is given only at retirement age 65.Regarding pension given to children, they will be allowed to take either their mothers' or fathers' pension which is higher not both.

On the revenue side, as taxes is the main source of governments' revenue several taxes increase took place as follow VAT increased from 19% to 23%, extra taxes were imposed on fuel, tobacco and Alcohol. Income and Corporate taxes were raised, luxurious cars' taxes were increased with range from 10 to 40% and new online tax was established. TV advertisements became subject to new tax of 20%. One-time tax was imposed on companies achieving minimum profit of 100,000 Euro. Tax ranges from 4% to 10% based on the company's profitability. Effort was done to fight against tax evasion as it's percentage in Greece is very high as mentioned before in this study. Moreover, public insurance contribution by both employee and employer increased by 3% (Dimitrios, 2011, pp47-52)

3- Structural Reforms

Greek government was aware of the need for long term structural reforms and they cannot depend on cyclical rebound if they want to compensate the profound cost of the crisis and immunize their economy from future crisis. Structural reform in Greece wasn't an easy process it touched the most sensitive areas in the Greek economy financial sectors, health care, pensions, judicial system, public administration and tax regime.

Regarding the financial sector the Hellenic financial stability fund completed bank recapitalization of Greece's four systemic banks it was very important step to retain stability in Greek banking sector. Also, government passed legislation aiming to improving the management and the restructure of private debt related to the non-performing loans (HFSF, 2015).

Greece's record on implementing reforms is good as it climbed 40 places in the World Bank's business environment ranking (Rodik, 2019). Greek government catalyzed their effort in reforming tax regime by boarding the base of tax payer, reforming property tax, combating tax evasion and increasing fraud penalties

Pension reform by increasing the minimum retirement age, reducing the generosity of pension benefit, introduce mechanism to index the retirement age to life expectancy.

Market reform by adapting privatization program in various sectors like energy and transport, launch public-private partnership to enhance managing state owned assets, strengthen competition law and minimizing administration bureaucracy to establish new business and reducing barriers to enter in certain sectors like maritime and above all reforms in public sector as public administrator in Greece enjoyed very bad reputation as corrupted and Mal functioning administration.Finally, Greek Government worked on improving efficiency and enhancing accountability.

CONCLUSION

Finally, no doubt that mainly the responsible for the current status of Greek economy are the successive governments they never worked on developing their economy. Instead they cheated and lied in order to join the single currency. Even when they offered the chance to reform after joining the euro they engaged in excessive borrowing and they never used that easy money to enhance their competitiveness or to develop their economy instead the pace of reform went through a major slow down after joining the euro, they thought that by joining the euro they become too important to fail" if it comes to a crisis Europeans will help us". So, there is a big question about the surveillance mechanism within the euro. Stability and growth pact were inadequate in its conception.

As the crisis was severe actions taken also were very tough in the form of harsh austerity measures and structural reforms to the most sensitive areas in the economy that has been protected for long period consequently the public opposition was very strong but at the end pre-requisite conditions of the troika to bailout Greece were applied strictly till the financial market started to regain confidence in the Greek economy after almost 10 years of the out broke of the crisis.

Learned lessons

1- Greece as a case provided very strong lesson for developing countries as Greece was given a great opportunity to develop its economy by easy money provided for it. But actually, it didn't grab the opportunity so the lesson here that countries should not engage in an excessive borrowing unless for purpose of modernizing their economies spending on items that will bring money in the future not paying debt by debt. Knowing that economic growth and advanced economy with real production and competitive advantage is the only way to accelerate progress towards economic development.
2- EU surveillance mechanism must be reconsidered as several Greek governments cheated was not any intervention from the EU ,however when the crisis occurred the EU as a whole was in trouble
3- Theoretical criteria for Optimal currency area should be taken into consideration before deciding to form monetary union, As Greece was not qualified at all to share one currency with country like Germany.

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موجز الدراسة أزمة الديون اليونانية و كيفية معالجتها ،و ذلك خلال الفترة (٢٠٠٩-٢٠١٨)

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تتحصر مشكلة الدراسة فى تحليل جذور أزمة الديون السيادية فى اليونان و كيفية معالجتها من قبل الحكومة اليونانية و مؤسسات الاتحاد الأوروبي .فى هذة الدراسة تم تحليل أزمة الديون السيادية فى اليونان و عرض اهم العوامل التى أدت إلى اندلاع الأزمة و بالتالي أدت إلى فقدان الثقة فى الاقتصاد اليوناني .حيث اصبح الاقتراض من أسواق المال العالمية شبه مستحيل.لذلك مفاوضات مطولة تمت بين الجانب اليوناني و ممثلو الاتحاد الأوروبي و صندوق النقد الدولى قبل الموافقة على حزمة إنقاذ مالية للخروج من الأزمة .بالرغم من الموافقة على التدخل لإنقاذ اليونان الا ان هذا التدخل كان مشروط باتباع اليونان لسياسة تقشف حادة لم يعتدها المواطنون من قبل .وتستهدف الدراسة التعرف على كيفية انضمام اليونان للاتحاد الأوروبي و استيفاءها الشروط الواجبة للانضمام إلى منطقة اليورو بالرغم من المعوقات إلى يواجها الاقتصاد اليوناني .بالاضافه إلى التعرف على كيفية مواجهة أزمة الديون السيادية من قبل الحكومة اليونانية.ويستفاد من الدراسة أولا ان على الدول عدم التوسع فى الاقتراض الا بهدف تحقيق تنمية و العمل على خلق ميزة تنافسية من اجل زياد الصادرات فى المستقبل ثانيا قبل اللجوء الى تكوين اتحاد نقدى يجب على الدول التأكد من استيفاء الشروط اللازمة للمنطقى المثلى للعملة الموحدة ثالثا يجب اعادة النظر فى نظام المراقبة المالية داخل الاتحاد الأوروبي لتجنب حدوث أزمات مستقبليه