

Effects of Global Financial Crisis on Greek Economy: Causes of Present Economic and Political Loss of Prestige

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Abstract: *The cause of global financial crisis in the world in 2007 – 2008 is the mortgage crisis in USA in August, 2007. The crisis caused an immense instability in markets and gradually became global. Effects of this crisis upon some countries such as Spain and Portugal were deeper and more destroying. Greece is one of these countries. It is seen that Greece has an economic structure consisting of high debt level, high budget deficit, low competitive power and unstable political structure. At the end of 2009, the political and economic crisis in Greece, which began as a debt crisis, turned out to be a Euro Zone crisis.*

Keywords: *Global Financial Crisis, Greek Economy, Debt Problem, Debts Sustainability, Economic and Political Reliability*

JEL Classification: *G01, G18, H63, H68*

1. INTRODUCTION

The financial crisis, which began in USA, first affected Europe and many developed and developing countries in the world and acquired a global dimension. The crisis, together with affecting many countries seriously, had a deeper and more destroying effect on some countries such as Spain and Portugal. Greece is one of these countries. In fact, the crisis was not the cause of the situation in Greece, but it would be a correct idea to say that the crisis was the one which triggered it, because the deterioration in economic and financial structure in Greece began much earlier. It can be said that the crisis caused it to be clearer. The financial crisis, which made the world feel its effects from mid – 2008, is seen to increase the public debt of many developed countries strikingly. That's to say, it can be said that the mortgage crisis in USA turned out to be a serious debt crisis especially in Europe. The debt problem and its effects brought about doubts about the future of European Union and Euro. While countries like United Kingdom and Ireland were affected by the banking and credit crisis seriously, such countries as Italy and Greece were not affected from these crises, but they faced debt financing. It can be said that there are many reasons for these problems. But, the striking point is the weakness of fiscal policies in European Union. Handling the point for Greece, the instability, insufficiency and reliability of political institutions, together with weak public finance and unsuccessful financial policies, can be seen. The aim of this study is to illustrate the negative effects of political corruption and degeneration on the economic structure and political reputation of Greece. In this context, in this study, firstly, political and economic reasons of the crisis in Greece will be handled, and then the precautions and results during the financial crisis will be examined.

2. POLITICAL ORIGINS OF FINANCIAL CRISIS IN GREECE

Greece can be said to be a remarkable country by both political and economic means globally. Its history has an important role in that. In 1974, after the decline of 7 years dictatorship, third Republic of Greece was established and later a lot of efforts were made to develop a steady democratic political system (Lyrintsiz, 2005: 242-243). Greek social society, when compared with other West European societies, had a weaker structure and Greek bureaucracy was not as strong as West European Bureaucracy (Sotiropoulos, 1995). The political party (PASOK), which came to power in 1981, dominated the political structure of Greece during 80s and 90s. There are two striking points here. First, political parties were held responsible for Greece's all problems. It is claimed that the unusual rate of foreign debt, insufficiency of public sector, infertility of public services and corruption of moral values are all related to the politics applied by political parties. That is, the state is abused in the direction of benefits of political parties. Second, reforms about education, transportation, medical,

markets and social security systems in Greece have all failed. In fact, PASOK government can be said to be aware of financial problems of Greece but government replied very slowly and avoided taking strict measures. Also, no political party took the situation into consideration during the election and nor did they mention the country's position (Lyrintzis, 2011). Later, the economic and political crisis turned out to be a Euro Zone crisis. In fact, the problems Greece is facing now are only a small part of financial responsibilities of member states of EU (Dabrowski, 2010).

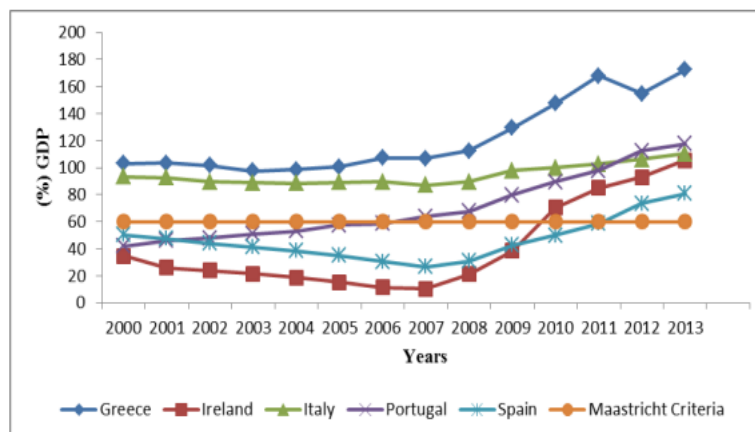
In short, it is possible to say that the current situation of Greece is a possible result of wrong policies applied in the last 25 – 30 years. This process is closely related with financial extravagancy and insufficiency of Greece government, unfair and infertile taxation system, unsustainable retirement, low competitive power, populist practices of political parties and organizational and political problems in EU and Euro Zone.

3. UNSUSTAINABLE AND CORRUPTED STRUCTURE IN ECONOMY

The idea of launching a unique money system in European Community was mentioned in 1970 in Werner report and this led to the establishment of European Monetary System (EMS). Greece became tenth member of European Community in 1981 and launched Euro as local currency (Clarke and Daley, 2010). The passage was thought to be more beneficial and to accelerate the modernization of economy. However, although the passage to Euro, at first, had such positive effects as development, high inflation and credibility of economy policies, it was seen that it brought about some negative causes as well (Kouretas, 2012).

For example, Greece, where export and import depended on tourism and sea transport was affected deeply by the gradual increase in Euro value in both sectors (Papanikos, 2012). Also, remarkable increases in public spending, together with wrong political choices, caused serious problems in competitive power of country and big financial instability. This is quite important to explain the situation of Greece (D'Atou, 2010).

The points, which Greece economy is sensitive about, can be collected under four topics. These points are seen to increase the worries about combined effects on financial expectations. The first of these points is financial instability. The rate of Greece's both budget deficit and debts to GDP can be said to be one of the highest in Europe. That the rate of prices, retirement and medical spending to GDP is quite high in Greece is second. The third is the important erosion in international competition affecting the economic performance and capacity to increase income taxes. The fourth is low reliability of financial statistics, the greatness of financial problems and government's approach and expressions about increasing worries about possible financial results (Papademos, 2010).



Graphic1. State Debts and Budget Deficits in Greece (2000-2011)

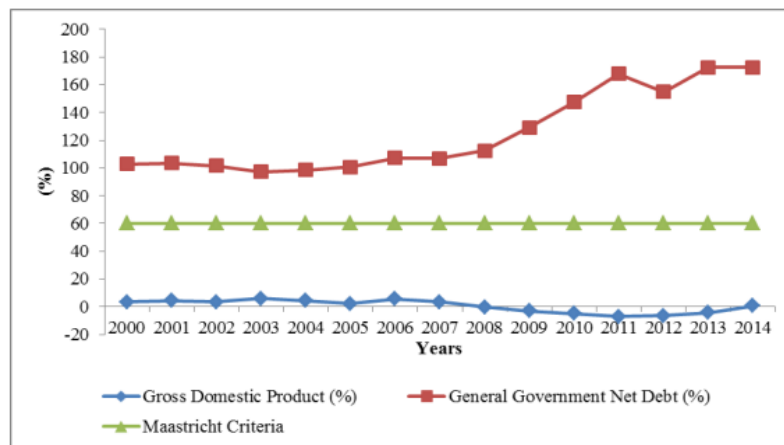
Source: IMF, Data and Statistics, IMF Data Mapper, WEO Database, 2013, <http://www.imf.org/external/data.htm>

The global crisis in Greece turned out to be a debt crisis by intensifying the financial problems. It also caused the institutions of high debt level and budget deficit rating to decrease the grade of country and to lose prestige in international markets, and this caused interest rates of loans to increase sharply (Vlachou, 2012: 171-172). The basis of Greece's debt crisis is the sustainability problem of debts and the reflection of uncontrolled increase to economy. Especially, it is seen that public sources are not

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managed rationally during the period of post 2000, also indiscipline public spending and lawlessness (Alogoskoufis, 2012).

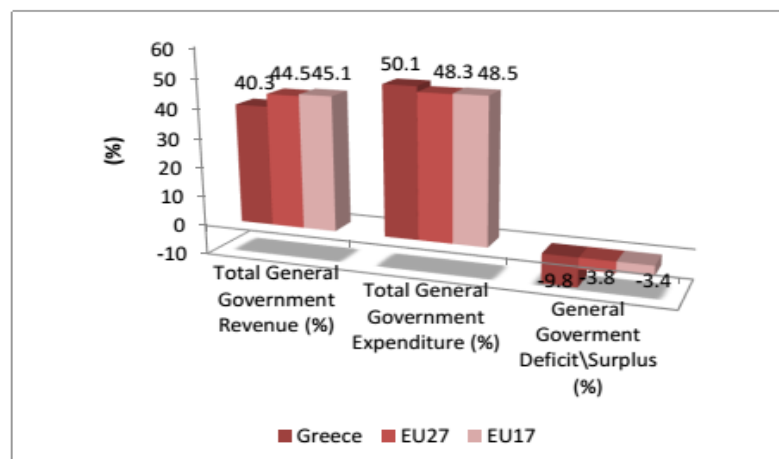
It can be said that the relation between debt and budget deficit is directly proportional. The change in budget deficit is reflected to the change in public debts and this triggers the budget deficit (Graphic 1).



Graphic2. Greece Government Deficit and Maastricht Criteria

Source: IMF, Data and Statistics, IMF Data Mapper, WEO Database, 2013, <http://www.imf.org/external/data.htm>

Countries of European Union are said to be unsuccessful and late to support Greece where crisis has been increasing. Later in this process, about financial sustainability of not only Greece but also many countries in European Union, worries began to emerge (Buiter and Rahbari, 2010).



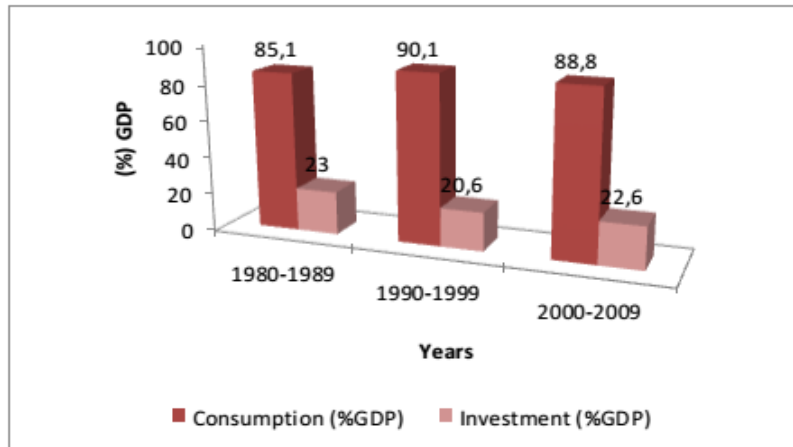
Graphic3. The comparison of Greece's Budget Income and Outcome with EU27 and European Region Countries (17) (Average between 2006 – 2011)

Source: European Commission, 2013, <http://epp.eurostat.ec.europa.eu/statisticsexplained/index.php/Nationalaccounts%E2%80%93GDP>

Generally, sustainability of debt is defined as a consistent Debt / GDP rate. This rate has been consistent from mid 1990s to 2007 in Greece. The deep recession caused the country to develop dramatically and also rate of Debt / GDP to increase (Bryson and Kruse, 2011). High priced precautions taken about public debt stock, which is above Maastricht criteria (60 % of GDP) and gradual increase of rate to GDP, 160 %, and the regression in production level caused big budget deficits to emerge in Greece (Graphic 2). The heavy debt crisis Greece had later spread to Portugal, Italy, and Spain and won a global dimension in region.

When budget income and outcome of Greece and EU are compared, budget income in Greece is seen to be lower than the average of EU27 and EU17 and budget deficit is seen to be high (Graphic 3). One of the most important reasons of it is claimed to be insufficiency of disincentive precautions in Greece and evasion of tax. It can be said that if evasion of tax is high in a country, it creates unfairness in

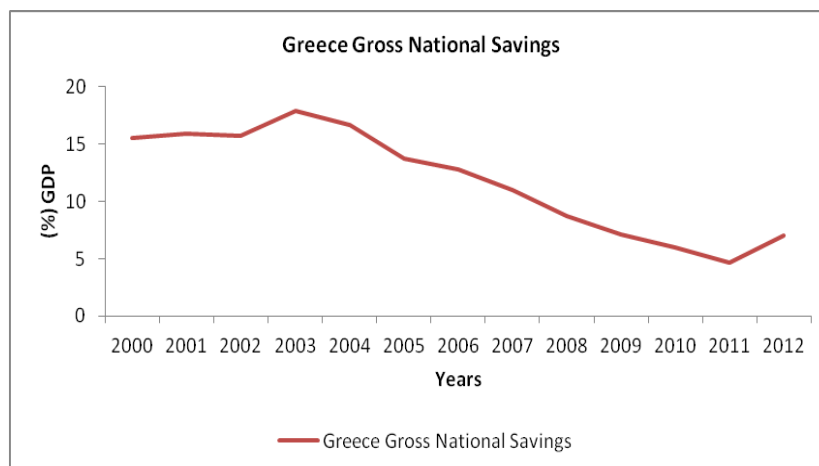
taxation system and affects the development negatively. The insufficiency of precautions in this subject increases the evasion. Especially, punishments towards evasion must be more disincentives, accountancy practices must be modernized, organizational frame forming the interaction between government and citizen must be simplified (Meghir, Vayanos and Vettas, 2010).



Graphic4. Consumption and Investment Spendings in Greece

Source: OECD, National Statistics, 2013, <http://www.oecd.org/statistics/betterlifeinitiative/measureingwell-beingandprogress.htm>

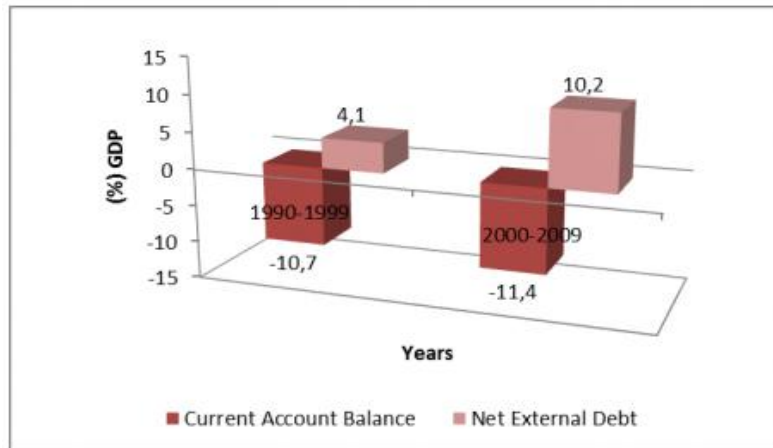
Looking at the period after 1980 in Greece, while less is spent in investments, more consumption spending is made. Great increases in public debts caused both effects during 1980s. The increase in public spending is caused by the pressure of high prices, heavy social security on public finances. This caused consumption spending to increase and investment spending to decrease (Graphic 4). Behind the decrease of investments, there are insufficiency of personal savings and so finance. It is seen that personal savings after 2000 in Greece fell dramatically (Graphic 5). In addition to this, most of the personal savings were indebted by government and government did not use it for investment. As a result, both public and private investment decreased (Meghir, Vayanos and Vettas, 2010).



Graphic5. Gross National Savings

Source: IMF, Data and Statistics, IMF Data Mapper, WEO Database, 2013, <http://www.imf.org/external/data.htm>

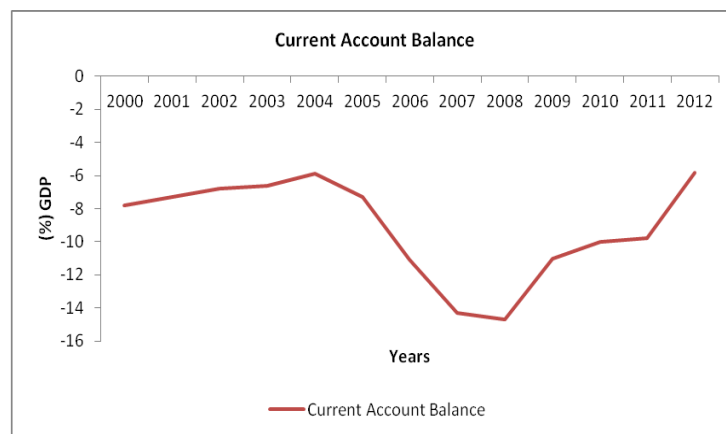
Quite a big part of foreign debt of Greece is public debt. In the last two decades, a dramatic increase is seen in Greece's foreign debt. Greece loaned foreign debt at the rate of 4,1% of GDP every year during 1990s. This increased to 10,2 % during 2000s (Graphic 6). However, the state could not effectively use the financial resources coming from foreign debts to increase the production capacity and nor could it realize the structural reforms to increase competitive power. An important portion of foreign debt is used for import directed at consumption.



Graphic6. Current Account Balance and External Debt (% GDP)

Source: OECD, National Statistics, 2013, <http://www.oecd.org/statistics/betterlifeinitiative/measuringwell-beingandprogress.htm>

While Greece was at 83rd place in Global Competitiveness Index in 2010, it declined to 96th place in 2013 (Schwab and Martin, 2012). The erosion in competitiveness as well as chronic weakness of Greek economy explains the structure of current deficit and why the export performance is lower than the other European countries (Sklias and Galatsidas, 2010: 167-177). In Graphic 7 shows Greece's current account balances after 2000. Greece imports more than it exports; in other words, it consumes more than it produces. The state provides some of its financing with foreign debt. The current account balance, which was in the rate of -7% of GDP in 2001 with the effect of decline in competitiveness, realized as the level of -15% of GDP in 2008. This rate is fivefold of the EU Maastricht Criteria. In the following period, this rate was about -10%. In 2001, current account balance of Greece was about -29,3 billion dollars, that is -9,8% of GDP, which is threefold of Maastricht Criteria. In the same period, this rate was 1,1% in Ireland, -3,2% in Italy and -6,4% in Portugal.



Graphic7. Greece Current Account Balance (2000-2011)

Source: IMF, Data and Statistics, IMF Data Mapper, WEO Database, 2013, <http://www.imf.org/external/data.htm>

On the other hand, it can be said that the debt-maturity structure of Greece Government has relatively short and irregular range. Moreover, it can be said that about 79% of government debt is held by non-resident investors, and net international investment position of Greece was at the level of -82,2% of GDP (Cabral, 2010).

When compared to previous periods, although the inflation rates were low in Greece between 2001 and 2009, they were at relatively high levels according to the EU criteria. In Greece, both prices and high increases in wages in comparison with the Euro zone have reduced the competitiveness of the country (Provopoulos, 2010). In Greece, the inflationary pressure strengthened during 2010. The increases in VAT rates and in Special Consumption Tax led to the realization of the inflation rate in 2010 as 4,7%. In 2011, there was a decline and the inflation rate was 3,3% (Graphic 8).



Graphic8. Inflation Rates in Greece (%)

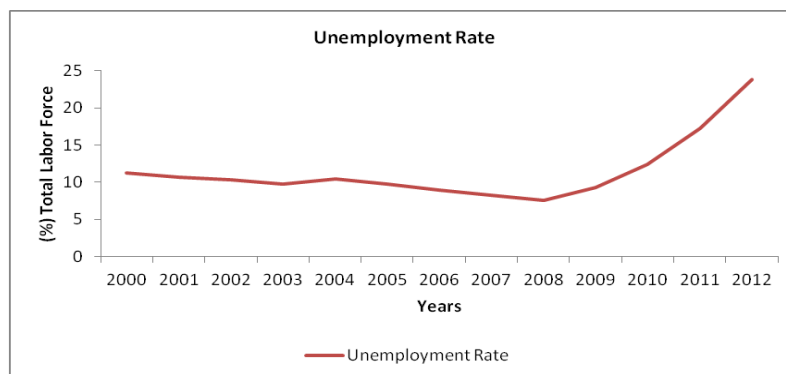
Source: IMF, Data and Statistics, IMF Data Mapper, WEO Database, 2013, <http://www.imf.org/external/data.htm>



Graphic9. Gross Domestic Product Rates in Greece (2000-2013)

Source: IMF, Data and Statistics, IMF Data Mapper, WEO Database, 2013, <http://www.imf.org/external/data.htm>

In this period, Greece was exposed to continuous credit-rating downgrades by international rating agencies, and rapidly increasing borrowing costs made the public debt management unsustainable. Greece’s economy entered a serious constriction period, especially after 2007 (Graphic 9). It can be said that the negative effects of the crisis were seriously felt in the European Union and the Euro zone experienced the greatest recession of its history in 2009. Afterwards, although this rate turned to positive, it has not exceeded the level of 2s%. After 2007, the Nominal GDP rate in Greece has continuously been negative value.



Graphic10. Unemployment Rates in Greece (2000-2013)

Source: IMF, Data and Statistics, IMF Data Mapper, WEO Database, 2013, <http://www.imf.org/external/data.htm>

While the debt crisis continues its pressure on the real economy, layoffs and the number of unemployed as well as the cuts in public expenditures have increased as a result of severe austerity

measures (Sesric Reports, 2011). Thus, this constriction brought up the unemployment problem seriously, the unemployment rate which was 7, 6% in 2008 increased rapidly and it reached the level of 17,3% in 2011. This rate is estimated to be 23,8% in 2012 (Graphic, 10). It is predicted that there will be an increase in employment and the unemployment rate will decrease if the reforms concerning economic structure and labor market are practiced as planned.

4. POLITICAL DISREPUTE CAUSED BY HIDDEN ECONOMIC MISTAKES AND FAILURES

In 2007, when the subprime mortgage crisis broke out, all of the world economy was expected to be affected by this crisis severely. One year later, there was no doubt for most countries and their regions about facing a financial system crisis with dramatic macroeconomic and social results (Dabrowski, 2008). One of the seriously affected countries from this crisis is Greece. In fact, Greece can be said to experience the problems long before the global crisis began. Fruitlessly and unconsciously waste of money due to practices causing economic and social degeneracy such as bribery, corruption and partisan behavior lie behind the high-level budget deficits, rapidly rising public debt, deficiency in investment spending and current account imbalance (Williams, 2010). In addition, in this negative process, two important developments that would shake the markets occurred in Greece in the end of 2009. The Greek Government coming to power in November 2009 revised the budget deficit of 2009 projected as 6, 7% of GDP and brought down it to 12, 7%. In April 2010, Statistical Office of the European Communities (Eurostat) declared that this rate would realize higher than 13, 6% (Nelson, Belkin and Mix, 2011). Then, this figure increased to 15, 4% by following an upward course. This rate is two times more than previously explained figure. In this process, the public finance data released by Greece in the past were understood not to reflect the fact. Furthermore, Greece made a six-month loan postponement request from the Dubai World owned by the Government of Gulf Emirate in November 2009. This news made a serious shock in the financial markets and, in the light of the fact that the financial statement in Greece rapidly deteriorated, distracted the attention of financial markets and rating agencies to the sustainability of Greece's financial and external imbalance. This event led to get damaged the thought that Euro Zone membership have the task of protecting against the risks (particularly credit risk) (Gibson, Hall and Tavlas, 2011). Most people agree that the Greek Government consciously changed the data and misled the authorities.

There are some reasons of Greece's being the first Euro Zone country to be saved during the crisis and of being one of the most important rescue operations in the history. The first of these is the structure of the public debt. An important part of the public debt is external debt. This heavy debt that Greece economy has dealt big blow to the banking sector that had no problems at first and led to the deepening of the crisis. Second is that this crisis did not remain limited to Greece but spread out all European Union countries. Third, the bankruptcy of Greece will be interpreted as European Union's inability to protect of its member, in other words, EU's failure.

International rating agencies' continuous credit rating downgrades of Greece discredited the investors. On the other hand, the measures taken by the Greek Government both provoked the reaction of the people and were unable to regain the trust of markets. After recognizing the seriousness of the incident and the size of the problem, the Government was forced to implement a plan to save the Greek economy by the EU and IMF. At the end of this process, in March 25th 2010, the Greek Government reached an agreement with IMF, European Central Bank (ECB) and European Commission on a 3-year and 110 billion euros plan, 80 billion funded by the EU and 30 billion by IMF. This recovery plan includes the realization of increasing the range of VAT; increasing the indirect taxes in cigarette, alcohol and oil; increasing the taxes of real estates and luxury goods; decreasing the total payments of public sector employees and making regulations on pension system. Within the framework of this agreement, Greece guaranteed that it would decline the budget deficit to 8, 1% of GDP in 2010 and 3% of GDP in 2014 and make extensive structural reforms aiming to make the economy more competitive. The plan was revised by the additional recommendations of IMF and European Union Commission in 2 May 2010 (Kouretas and Vlamis, 2010: 391-404). In fact, the problem in Greece should not be looked only in economic framework. It is obvious for a successful solution that there should be more than taking severe financial measures and - controlling public expenditures. In this context, the political and social dimension of the event should be paid attention (Koutsoukis and Roukanas, 2011:26).

Upon the remaining incapable of recovery plan of 110 billion dollars funded by the EU and IMF, a second recovery plan was established for Greece, and, within the framework of this plan, it was claimed as a prerequisite that Greece's debt of 205 billion dollars to private sector would be restructured, and thus the public sector would make a self sacrifice (Kouretas, 2012). In this sense, it is predicted that private sector creditors will contribute 106 billion dollars to the Greek economy through an exchange of debts by losing 53,5% of their bonds on nominal value. Following this debt configuration, Greece's second economic adjustment program was approved by Euro Zone countries in 14 March 2012. In this context, it was agreed that Greece would be paid additional funds of 130 billion euros, 28 billion of which would be provided by IMF, together with the unpaid portion of the first program between 2012 and 2014. In the context of the second adjustment program, Greece's public debt to GDP ratio is targeted to reduce the level of 124% by 2020 (European Union, 2013).

In fact, Greece is just the visible tip of the iceberg (Roubini, 2013). In the EU area, only the Greek economy or several countries such as Ireland or Portugal should not be regarded as problem. Unless a determined and extensive solution policy is established, other several European countries including France will be exposed to public debt crisis and economic crisis afterwards. This is an important element that threatens the integrity and future of the European Union.

5. CONCLUSION

Since 2007, world economy has lived one of the biggest crises ever. The financial crisis began in USA and spread to the world and affected many both developed and developing countries. One of these countries is Greece. The crisis not only accelerated the corruption in economy but it also revealed the chronic weaknesses in it.

It is clear that the discussion about Greece's exclusion of European Common Currency should have been made in 2001 when Greece accepted Euro as local currency. The support, Europe gave to save Greece, is a price it should pay and it will go on paying. Greece is also aware of it.

To solve the problems in Greece in a short time, there is a need for a structural reform about the sustainability, competitiveness and transparency of economy. This must not only be a change in economy but also in politics and society, and this change must be supported. In fact, this is not an economic problem but a loss of prestige.

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