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## Effects of Global Financial Crisis on Greece Economy

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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 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. In this context, this study seeks to examine effects of incorrect economic and political decisions, and dishonest statements about their results on the progress of the crisis and on Greece economy and to propose solutions.

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### 1. Introduction

In 2007, the financial crisis that started in the US quickly gained a global dimension by influencing many developed and developing countries. The effects of the crisis were particularly more profound and destructive in some countries. Greece is also among these countries. In fact, it will be more accurate to describe the situation in Greece as triggered by the crisis not directly resulted from the crisis as deterioration in the economy and financial structure of the Greece had started long before the crisis. So, it can be argued that the situation became more apparent with the crisis.

It is seen that the financial crisis significantly increased public debts of many developed countries since the mid 2008. That is it can be said that the crisis turned into a serious debt crisis particularly in Europe. The crisis has brought

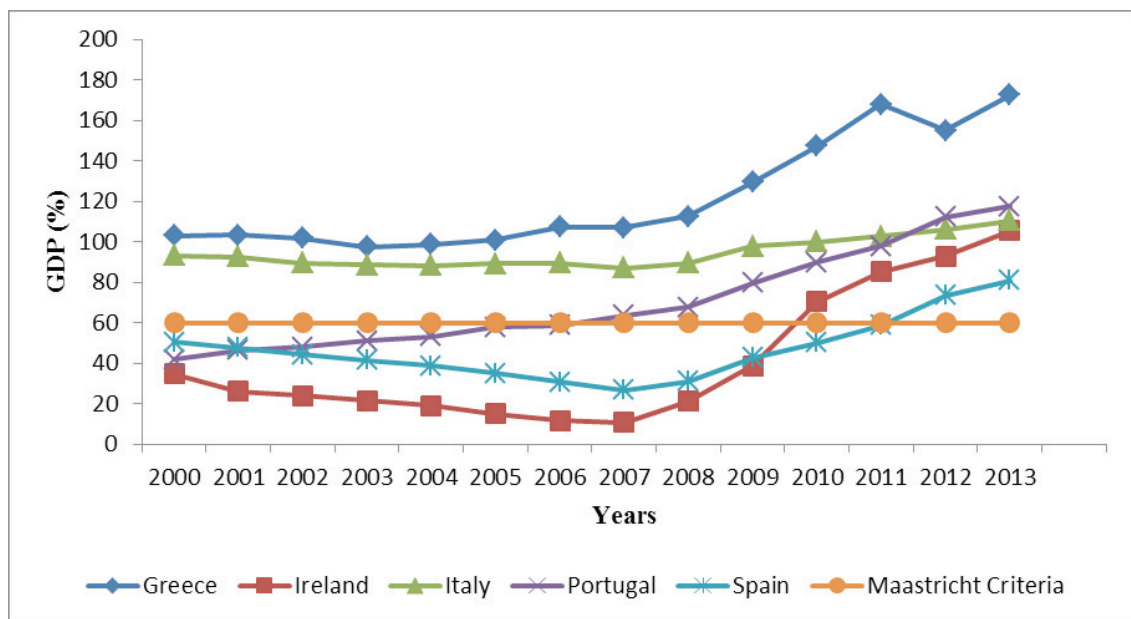
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about many uncertainties about the future of Euro. The interesting point with regard to the problems faced in this process for European Union countries is the infirmity in the financial policies. When the problem is considered in terms of Greece another dimension with regard to instability, insufficiency and unreliability of political institutions can be seen besides weak public financial policy and ineffective financial policies.

## 2. Unsustainable economic structure in Greece: Deterioration in basic economic indicators

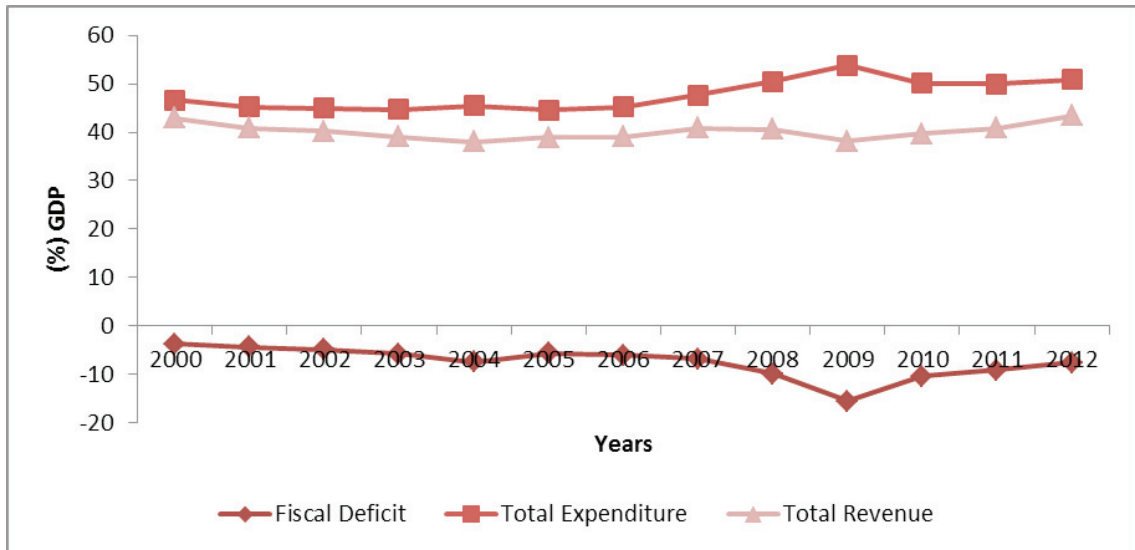
It is possible to say that the current situation of Greece is a possible result of wrong policies applied in the last 25 – 30 years. This process is closely related with financial extravagancy and insufficiency of Greece government, unfair and infertile taxation system, unsustainable retirement, low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

Greece became tenth member of European Community in 1981 and launched Euro as local currency (Clarke & Claire, 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). 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).



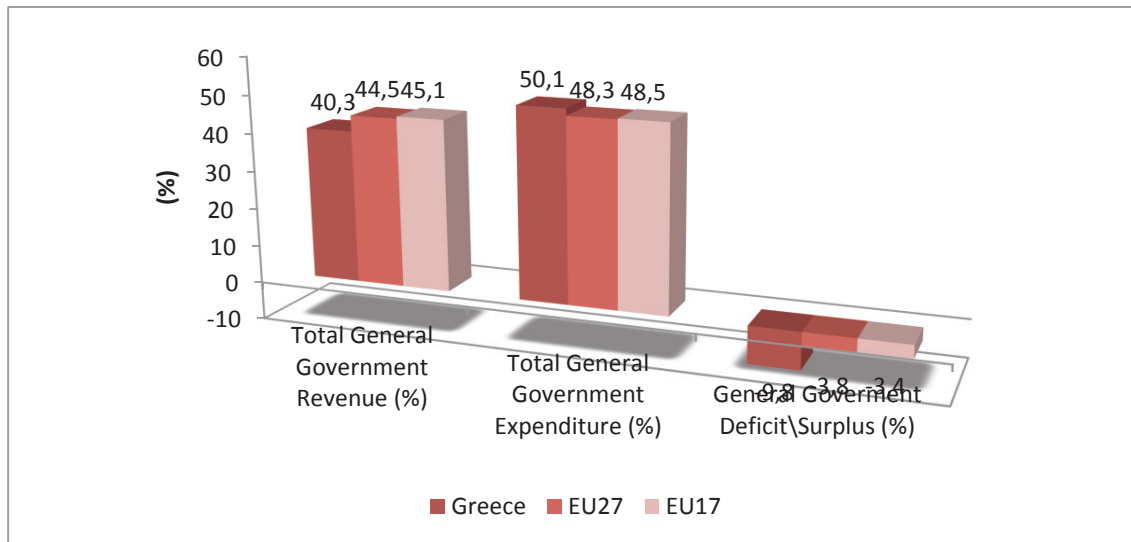
Graphic 1: General government net debt in PIIGS (2000-2013)

For many years, Greece managed to contract debts with low interest rates by playing on basic economic indicators thanks to accountancy support provided by Goldman Sachs (Wagner & Machnowski, 2010). When the process before the crisis is taken into consideration, it is seen that the rate of Greece debts to its GDP is one of the highest in Europe. This rate particularly increased after 2000 and surpassed 160% and far beyond Maastricht criterion (60% of GDP). When compared to Spain, Portugal, Italy and Ireland, the situation can be seen clearly (Graphic 1). The international competition power of the country significantly eroded. In addition to all these, probably the most attention grabbing elements which ignited the wick of the crisis are the government's approach and statements that increased the uncertainties and raised worries about the low reliability of financial statistics and the real extend of financial problems and their possible financial results. It can be said that European Union Countries were late to read the indicators and failed to support Greece as the crisis escalated in the country.



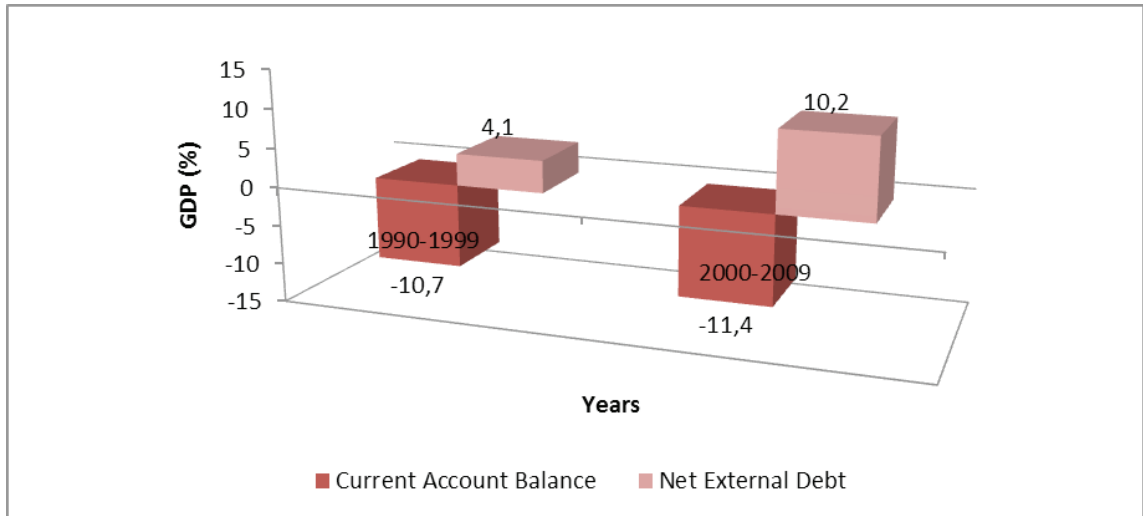
Graphic 2: Greece government deficit

Before the crisis and in the process of the crisis while most loses were expropriated, most revenues were privatized. It can be said that tax payers are responsible for more than 80% of Greece’s debt. High cost measures with regard to public debt stock led to large fiscal deficits (Graphic 2). The rate of public deficit to GDP in Greece has always been higher than averages in European area since its entrance into Euro zone.



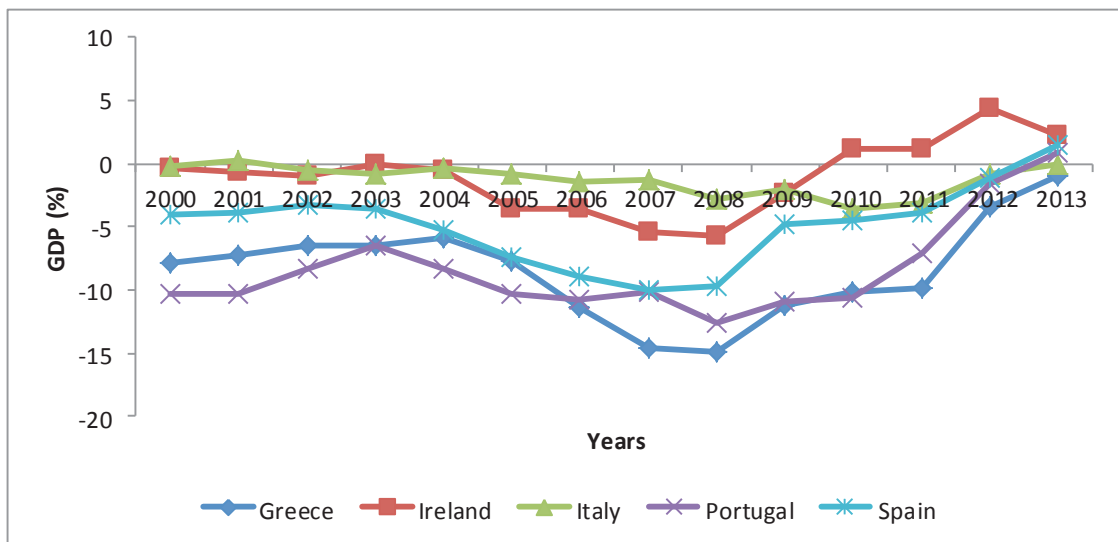
Graphic 3: The comparison of Greece’s budget income and outcome with EU27 and European region countries (17) (average between 2006 – 2011)

One of the most important problems Greece has experienced in recent years is decrease in tax revenues of the government. Tax revenues have perpetually been lower than expectations. 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). It is argued that there are serious levels of tax evasions due to inadequacy of pressures and deterrent measures created by the high wage costs and heavy social security load. It is argued that the insufficiency of measures also increases malpractices (Meghir, Vayanos & Vettas, 2010).



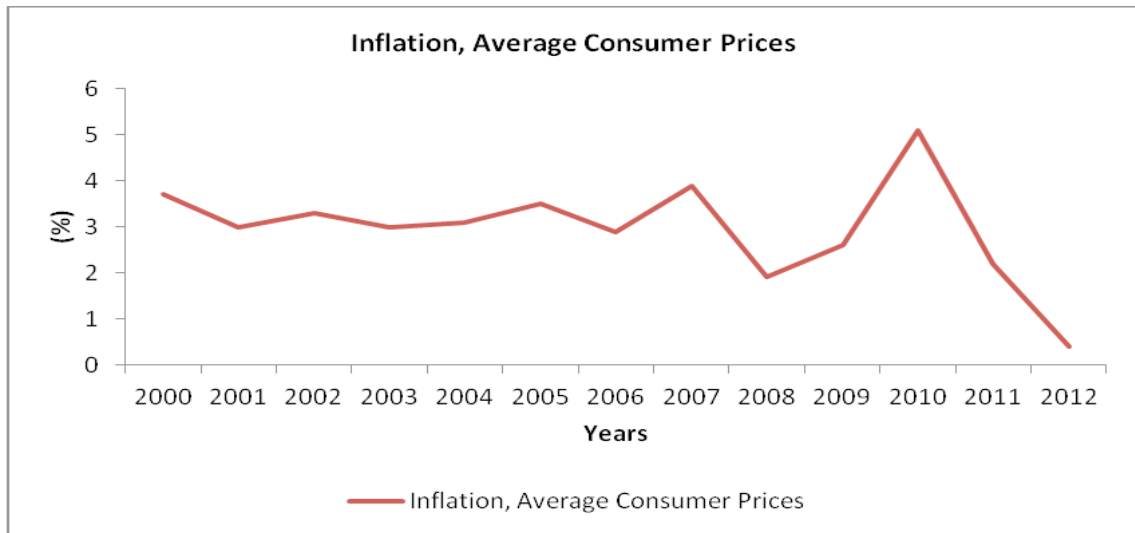
Graphic 4: Current account balance and external debt (% GDP)

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 4). 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.



Graphic 5: Greece current account balance (2000-2013)

While Greece was at 83<sup>rd</sup> place in Global Competitiveness Index in 2010, it declined to 96<sup>th</sup> place in 2013 (Schwab & 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, & Galatsidas, 2010). 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. 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 (Graphic 5).



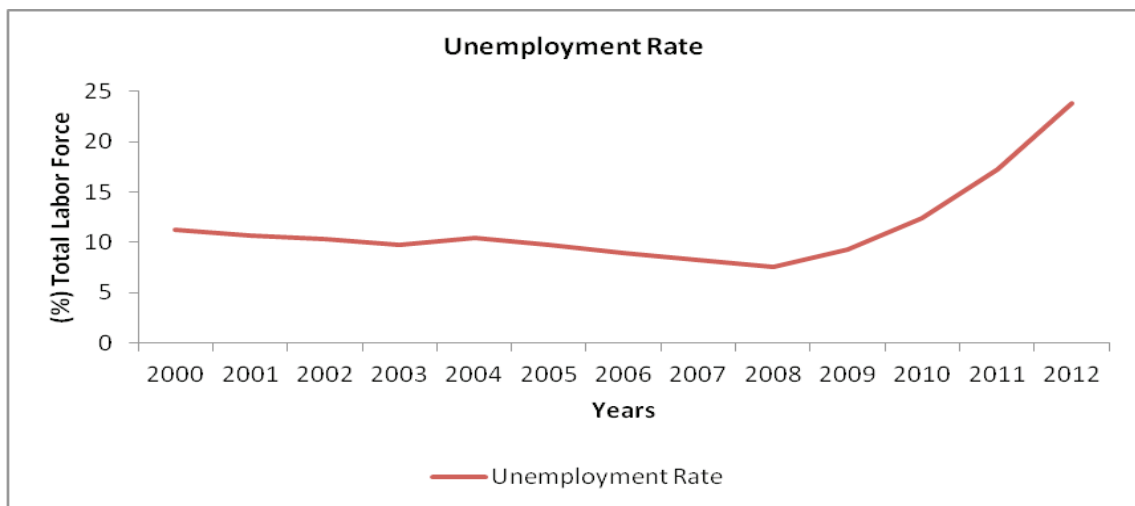
Graphic 6: Inflation rates in Greece (%)

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 6).



Graphic 7: Gross domestic product rates in Greece (2000-2012)

Between 2000 and 2007, Greece had one of the fastest growing economies in Euro zone. In this period, the country's economy increased more than 4% on average. Greece's economy entered a serious constriction period, especially after 2007 (Graphic 7). 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.



Graphic 8: Unemployment rates in Greece (2000-2012)

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 8). 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.

### 3. Political disrepute caused by hidden economic mistakes and failures

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, 2013) declared that this rate would realize higher than 13,6% (Nelson, Belkin & 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 & Tavlas, 2011). Most people agree that the Greek Government consciously changed the data and misled the authorities. It is argued that Greece does this to stay within monetary rules of the European Area (Abboushi, 2010).

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 25<sup>th</sup> 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 (2013). 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. 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 & Roukanas, 2011).

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).

#### **4. 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

combination of high rates of public deficit and debts to GDP, shrinking tax base and dysfunctional tax collection system increased fragility and liquidity crunch in Greece economy. 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.

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.

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. It will not be easy to regain this prestige.

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