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Greece and the Euro: The Chronicle of an Expected Collapse

Ten years after Greece's accession to EMU, the venture has proved to be almost a complete failure. Obviously, the country joined EMU disappointingly unprepared. After EMU accession, Greece failed to seek the necessary adaptations. Its economic policy was inconsistent with the economic logic and rules of the game of a monetary union. EMU did not in itself lead to the Greek crisis. Nevertheless, the supervisory arrangements clearly failed to work. Moreover, the unfolding of the crisis was assisted by EMU's inherent weakness in managing asymmetric disturbances and the absence of early warning and rapid intervention mechanisms.

On 1 January 2001, Greece joined the eurozone, following a collective effort to adapt to meet the convergence criteria of the EU Treaty (1992). The country's participation in the third phase of EMU had become a key national objective. Through its EMU membership, the country was looking forward to significant economic and political advantages. Greece's path in EMU, despite frequent disruptions, seemed manageable. However, the debt crisis that erupted in 2009 and peaked in 2010 has amply revealed the chronic weaknesses of the Greek economic and political system.

This raises some questions of great interest to both policy and academic research: what are the outcomes of Greece's membership and progress in EMU? Did EMU contribute to the Greek crisis and financial collapse? After this phase of financial suffering, what does the country's European future look like? This paper attempts to answer these questions, focusing on some key economic and institutional issues.

Evaluation of Ten Years of Greece's Participation in the Euro Area

After ten years of Greece's participation in the eurozone, it is useful to attempt an assessment of its main achievements and failures.[1] It is logical to begin by examining the main expectations at the time of EMU accession.

The Expected Effects

Before Greece's entry into EMU, there was a general consensus on the expected benefits.[2] The reduction of transaction costs and the elimination of exchange rate uncertainty were expected to boost trade and production. The transfer of responsibility for monetary policy to the new common institutions would release Greek monetary policy from domestic political pressures, thus ensuring price stability. Monetary stability was expected to enhance the propensity to invest. A decrease in the nominal and real interest rates and their stabilisation at low levels was also expected to help with this aim. Due to the adoption of an international currency, it was expected that the external liquidity of the Greek economy would be ensured to a great extent. Also, the country would be compelled to proceed, at last, with the reforms needed to endow the Greek economy with modern institutions and structures. Political benefits were also expected from joining the euro[3], provided that EMU had a positive effect on the process of European political integration.

Despite the frequent emphasis of these benefits, realistic analysis in Greece and abroad regarded the country's participation in the euro as a major challenge that entailed significant risks.[4] Concerns were raised over the state of the Greek economy and its ability to meet the requirements of the new competitive environment. The country would no longer be able to use monetary or exchange rate adjustments to rem-

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1 M.G. Arghyrou: The consequences from the accession of Greece to the EMU: Initial assessments, KEPE, Athens, 2007 (in Greek); N. Christodoulakis: Ten years of EMU: Convergence, divergence and new policy priorities, LSE, The Hellenic Observatory, GreeSE Paper No. 22, 2009; P. De Grauwe: The Euro at ten: achievements and challenges, in: Empirica, Vol. 36, 2009, pp. 5-20.

2 P. De Grauwe: The Economics of Monetary Integration, 4th ed. Oxford 2000; A. Kotios: Greece in the Euro area - From nominal to real convergence, in: Scientific Yearbook of the Department of Planning and Regional Development, University of Thessaly, Volos 2000, pp. 341-365 (in Greek).

3 P. De Grauwe: The Economics of Monetary Integration…, op. cit.; O. Issing: Europe, political union through common money? Occasional Paper No. 98, 1996, Institute of Economic Affairs, London.

4 A. Kotios: The two faces of the EMU, in: Europaiki Parousia, monthly publication on Europe, December, 1997 (in Greek); A. Kotios: Greece in the Euro area…, op. cit.; N. Thygesen: The benefits and costs of currency unification, in: H. Siebert (ed.): The Completion of the Internal Market, Tübingen 1990, Mohr-Siebeck, Kiel Institute of World Economics, pp. 347-385.

edy competitive disadvantages or adverse economic developments at a national level. Due to the reduced mobility of certain factors of production, but also because of restrictions on fiscal policy, future incomes and structural policies would have to bear the weight of the actual adjustment.

In the case of national macroeconomic disturbances, EMU member states would no longer have the necessary economic policy arsenal. Therefore, the weight would have to be carried by a limited number of policies, such as income and structural policies. EMU did not provide any mechanism for the management of a national or collective disturbance. Fiscal disturbances, such as the excessive indebtedness of a country, were considered impossible, due to the rules on budgetary discipline.

Evaluating the Results

Undoubtedly, Greece has benefited from the advantages that a single currency area offers, such as the elimination of currency risks and uncertainties as well as the elimination of currency conversion costs in trading with other eurozone countries. Furthermore, liquidity for foreign trade has improved, since trade within the eurozone is carried out in euros. A considerable part of the invoicing and payment for imports in trade with non-eurozone countries is also now carried out in euros. This has removed the exchange scarcity that characterised Greece for decades. However, it has also facilitated imports. The liberalisation of capital and the country's participation in a stable monetary union allowed, at least until 2007, an unimpeded flow of capital and a massive reduction in borrowing rates to almost the same level as the German rate.[5] Capital inflows into Greece took the form of loans from the public and private sectors, which gradually stretched the balance of income to the maximum, due to high interest payments.[6] Unfortunately, the country's performance in attracting foreign investment has been an absolute disappointment, due to internal structural weaknesses.[7]

Inflation in Greece has been consistently around 50% higher than the eurozone average, which has caused a cumulative increase in Greek prices of 32.8% over the period 1999-2007. It has also caused a comparatively large effective appreciation (15-20% depending on the calculation used) of the euro against the other euro partners.[8] Thus Greece has improved its monetary stability in comparison to what it was previously but not in comparison to other EMU countries, which has had adverse effects on price competitiveness and foreign trade. The International Monetary Fund (IMF) estimates that the Greek economy's loss of competitiveness over the past 10 years has amounted to 25%.[9] Moreover, the bulk prices of internationally traded Greek goods have continually converged towards those of other EMU countries, thus increasing price levels in the country.[10] In comparison, income convergence has been slower.[11]

On the issue of fiscal discipline, the country's attempts have been a miserable failure.[12] Throughout the period following EMU accession, Greece's budget deficits were consistently above the permissible threshold of 3% of GDP, generating ever-increasing public debt. The country was put under EU surveillance (excessive deficit procedure) in 2006-2007; however, a flurry of fiscal waste followed this in 2008 and 2009.

According to the endogeneity hypothesis of the theory of optimum currency area[13] Greece would be forced to make major structural and institutional changes. However, these issues were brushed aside, even after the country joined the euro. Without these adjustments, it would be impossible for the country to survive, in the long term, in the new competitive environment. Unfortunately, the latest developments have confirmed this prediction.[14]

Finally, special reference has to be made to the so-called "Greek paradox".[15] Although the country has been unable to

5 M.G. Arghyrou, A. Gregoriou, A. Kondonikas: Do real interest rates converge? Evidence from the European Union, in: Journal of International Financial Markets, Institutions and Money, Vol. 19, 2009, pp. 447-460; Deutsche Bundesbank: Zur Problematik makroökonomischer Ungleichgewichte im Euro-Raum, in: Monatsbericht July, 2010, pp. 17-40; EEAG: The EEAG Report on the European Economy, "Greece", CESifo, Munich 2011, pp. 97-125; J. Matthes: Ten years EMU – Reality test for the OCA endogeneity hypothesis, economic divergences and future challenges, in: Intereconomics, Vol. 44, 2009, No. 2, pp. 114-128.

6 Deutsche Bundesbank, op. cit.; EEAG, op. cit.; K. Schrader, C.-F. Laaser: Den Anschluss nie gefunden: Die Ursachen der griechischen Tragödie, in: Wirtschaftsdienst, Vol. 90, 2010, No. 8, pp. 540-547.

7 Eurostat: Foreign Direct Investment Statistics, 2010.

8 Deutsche Bundesbank: Nominale und reale Wechselkursentwicklung während der Finanzkrise, in: Monatsbericht, July 2010, pp. 41-58; EEAG, op. cit.; J. Matthes, op. cit.

9 IMF: Greece, 2011, accessed on 20/5/2010 from: www.imf.org/external/np/exr/faq/greecefaqs.htm.

10 P. De Grauwe: The Euro at ten..., op. cit.; K. Funke, I. Koske: Does the law of one price hold within the EU? A panel analysis, in: International Advances in Economic Research, Vol. 14, 2007, pp. 11-24; P.R. Lane: The real effects of EMU, IIIS Discussion Paper, No. 115, January 2006.

11 N. Christodoulakis, op. cit.

12 M.G. Arghyrou, J.D. Tsoukalas: The Greek debt crisis: Likely causes, mechanics and outcomes, in: Cardiff Business School Working Papers Series, No. E2010/3, 2010, EEAG, op. cit.; European Commission: The economic adjustment programme for Greece, in: European Economy, Occasional Papers, Vol. 61, 2010.

13 J. Matthes, op. cit.; F.P. Mongeli: European economic and monetary integration, and the optimum currency area theory, in: European Economy, Economic Papers, No. 302, February 2008; T.D. Willett, O. Permpoon, C. Wihlborg: Endogenous OCA analysis and the early euro experience, in: The World Economy, 2010, pp. 851-872.

14 OECD: Economic Surveys: Greece, Paris 2009.

15 M. Mitsopoulos, T. Pelagidis: Economic and Social Turbulence in Greece: The Product Markets Are a No-brainer, the Labour Market Is Not, in: Intereconomics, Vol. 44, No. 4, 2009, pp. 246-254.

make the necessary adjustments, it has achieved high annual GDP growth compared to the eurozone average, allowing it to converge in real terms. Nevertheless, the factors that contributed to this development were occasional or short-lived. Among these factors, we can cite (1) the increased liquidity of the Greek economy, driven by easy and cheap borrowing due to Greek EMU membership, (2) the high fiscal deficits of the Greek state, which were used to boost domestic public and private consumption, (3) the increase in productivity in certain sectors of the Greek economy, (4) the liberalisation of certain markets (e.g. telecommunications and financial services), (5) access to the markets of the Balkan countries for exports and investment, (6) inflows from the EU Structural Funds and (7) the Olympic games infrastructure.

According to the above remarks and to an empirical observation of the crisis, the negative effects of Greece's participation in EMU evidently outweigh the positive ones.

Factors Determining Greece's Performance in EMU

Politics Take Precedence over Economic Realism

From a national point of view, Greece's participation in EMU was primarily a political objective, similar to its earlier membership in the EEC. The leading political class felt that Greece should avoid being classified as a country with looser participation, especially after the EU's enlargement to the east.[16] Nevertheless, there has not been any substantial confrontation of arguments for and against the country's participation in EMU, a possible deferral of accession, the appropriate mix of policy adjustment measures required, the intensity and distribution of related costs, and other key issues. On the contrary, the benefits of adopting the euro were, from the very outset, overemphasised, while the potential risks were investigated in a negligent manner.

EMU has been, for the most part, a political project. The political impetus came mainly from France and Italy, two countries that wanted to eliminate the dependence of their economic policies on the policy of the Bundesbank.[17] They also sought the stronger integration of post-unification Germany into the European structures. However, the desired currency area deviated to a great extent from the model of an optimal currency area[18] for many reasons, mainly because it encompassed countries with different structures and different competitive capabilities. Germany, in order to fend off an inflationary union, agreed to participate in EMU on the condition that the monetary union adopted the monetarist paradigm of the Bundesbank. Consequently, a primarily political structure was put forward, based on the traditional German culture of monetary stability (*Stabilitätskultur*). Countries with divergent cultures, such as Greece, would have to adapt or experience a major disruption. Economic pragmatism advocated a deferral of EU membership for those countries that had weak economic structures, an inflationary culture and an inclination to act upon the demands of organised interest groups. This contradiction explains, to a large extent, both the ill-considered and hasty integration of Greece into EMU and its unceasing divergence from the fundamentals.

Inadequate Adjustment Policy for EMU Accession and Negative Initial Conditions

Policy adjustments to achieve readiness for joining EMU started very late in Greece, essentially after 1997.[19] There was little time available to improve the competitiveness of the Greek economy. Consequently, the country focused on fulfilling the limited and purely "economistic" convergence criteria of the treaty; these criteria ignored the real economy and the prerequisites of a monetary union that brought together unequally developed and politico-culturally different countries.

The mix of economic policies used for the adjustment was both insufficient and full of internal contradictions. It was insufficient as it dealt only with the hard drachma, high interest rates and some tax increases; other instruments available to economic policy, such as the containment of expenditure and efficient expenditure in the public sector, were discarded. It was contradictory because the restrictive monetary and exchange rate policy, which was politically easier to apply than other changes, was undermined by the expansionary fiscal and income policy. Moreover, the policy of high interest rates had a negative impact on fiscal adjustment, while the policy of real appreciation of the drachma and the tax increases hurt the productive capacity of the country.

In conclusion, Greece's accession to EMU was based on a policy of limited adaptation, with an emphasis on just a few nominal macroeconomic indicators and the use of creative accounting, as was discovered later. Public debt levels were excessive, the drachma was overvalued and, as a result, the country found itself at a permanent competitive disadvantage. Structures were distorted, competitiveness was reduced, social habits were inflexible and, above all, the Greek political system was characterised by clientelism and corruption. Consequently, the country joined EMU disappointingly unprepared.

16 A. Kotios: Greece in the Euro area…, op. cit.

17 J. Starbatty: Sieben Jahre Währungsunion: Erwartungen und Realität, in: Tübingen Diskussionsbeiträge, Vol. 308, 2006.

18 F.P. Mongeli, op. cit.

19 A. Kotios: Konvergenzkriterien und makroökonomische Anpassung in Griechenland: Visionäres und Realisierbares, in M. Papaschinopoulou (ed.): Griechenland auf dem Weg zur Europäischen Wirtschafts- und Währungsunion, Baden-Baden/Athen 1999, Nomos Verlag/Ant. Sakkoulas, pp. 99-124.

Disregard of the EMU Game Rules and Domestic Policy Inconsistencies

The accession to a new economic and political environment requires compliance with the new rules and an ongoing adaptation effort. "After" is more critical than "before".[20] The main features and fundamental rules of EMU are as follows:[21]

- Monetary policy is supranational and considerably depoliticised; decisions on monetary policy are taken collectively by the new European institutions, which act for the entire eurozone with the sole aim of ensuring price stability.
- Fiscal and income policies remain decentralised; that is, they continue to be the responsibility of the member states. Nevertheless, there are practical and institutional constraints. Countries that join the euro with a deficit close to 3% of GDP and debt over 60% of GDP face greater restraints on their real fiscal flexibility.
- Intra-market competition is increased; the possibility of affecting it through changes in real exchange rates or through changes in national money supply is eliminated when a country joins EMU.
- National prices, productivity and its determining factors (e.g. wages, technology, institutions) are key aspects of competition.
- Competition between national systems is increased in the areas of taxation, social security, public administration, environmental protection and others, since these areas affect economic performance, prices and investment allocation.
- There has also been a trend towards further concentration of economic activity in already developed areas of the EU; thus, regional development disparities are likely to increase in the future.

A new competitive environment and a new operational framework for economic policy have taken form. All participants should be aware of the rules of the game and comply with them. This has not happened in the case of Greece.[22] Having experienced the fatigue of a short-lived macroeconomic adjustment to the convergence criteria, Greece returned to the familiar paths of fiscal mismanagement. After EMU accession, Greek fiscal deficits were constantly above the Stability Pact thresholds. Debt continued to rise. The country practised a dangerous pro-cyclical fiscal policy.[23] Meanwhile, the internal economic environment deteriorated further, thus reducing the attractiveness of the country for foreign direct investment. Private savings fell sharply, while public savings were negative.[24] The cheap money that was channelled abundantly into the country was not used for productive investment but instead fuelled domestic demand, further widening the current account deficit and, especially, the balance of trade.[25] In conclusion, Greece has applied completely inappropriate policies.

The Issue of Macroeconomic Imbalances Within EMU

Significant macroeconomic imbalances[26] and divergent competitiveness[27] have been observed in the euro area during its ten years in operation. In Greece and other countries on the eurozone periphery, there has been strong growth in domestic demand, relatively higher prices, an erosion of price competitiveness and, thus, current account deficits.[28] These chronic imbalances reflect the internal imbalances. The current financial crisis has brought to the surface important issues of the Greece economy, such as the large deficits in external trade and competitiveness.[29] Undoubtedly, there is a correlation between the twin deficits: large budget deficits lead to increased domestic demand, rising prices and, finally, increased current account deficits. As long as foreign capital inflows are used to finance these deficits, the vicious cycle continues. This was indeed the case in Greece.[30] Large fiscal deficits interacted with ever widening external deficits. The crisis has simply highlighted and accelerated the problem of the already present macroeconomic imbalances in the eurozone. It has revealed that the developments of the first few years of EMU were not sustainable in countries like Greece and the rest of the cohesion countries. A characteristic sign of this is that Greece had a trade account deficit of 5% of GDP in 1999, which skyrocketed to 14.6% of GDP in 2008.[31] This deterioration in the external balance heightened

20 B. Herz, A. Kotios: Coming back to Europe: Greece and the Euro, in: Intereconomics, Review of International Trade and Development, Vol. 35, 2000, pp. 170-176; A. Kotios: Greece in the Euro area…, op. cit.

21 A. Kotios, ibid.

22 J. Boysen-Hogrefe: Ist Griechenland noch zu retten? Und der Euro?, in: Kiel Policy Brief, Institut für Weltwirtschaft Kiel, No. 19, 2010; EEAG, op. cit.; K. Schrader, C.-F. Laaser, op. cit.

23 K. Aristotelous: What is the Effect of EMU on Greece's Exports to the Eurozone? In: South-Eastern Europe Journal of Economics, Vol. 1, 2008, pp. 39-51; European Commission: A structural picture of Greek exports: Insights from disaggregated data, in: Quarterly report on the euro area, III, 2010, pp. 28-31.

24 EEAG, op. cit.

25 N. Christodoulakis, op. cit.

26 Deutsche Bundesbank: Zur Problematik…, op. cit.

27 European Commission: Surveillance of Inta-Euro-Area – Competitiveness and Imbalances, in: European Economy, Vol. 1, 2010; European Commission: The impact of the global crisis on competitiveness and current account divergences in the euro area, in: Quarterly report on the Euro area, Special issue, 2010.

28 M.G. Arghyrou, G. Chortareas: Current account imbalances and real exchange rates in the euro area, in: Review of International Economics, Vol. 16, 2008, pp. 747-764; K. Schrader, C.-F. Laaser, op. cit.

29 Deutsche Bundesbank: Zur Problematik…, op. cit.

30 EEAG, op. cit.

31 Ibid.

Greece's net liabilities abroad[32] and also reflects the large difference between national savings and net investment.

At the same time, the EU's northern countries have improved their competitive positions through a disciplined fiscal and income policy and the enhancement of non-price competitive factors (e.g. innovation, entrepreneurship, economic environment). Because of inflation and wage increases, Greece's competitiveness index fell, as far as prices are concerned, compared to those of other EMU members.[33]

Negative Effects Associated with Errors in the Design of EMU and Its Imperfect Functioning

An important question that needs to be answered is whether EMU itself, through its structures, mechanisms and working procedures, has adversely affected the progress of Greece in the euro area.[34]

Firstly, the convergence criteria for joining EMU have brought heterogeneous countries under the umbrella of the eurozone. The fact that Greece entered EMU with a debt larger than 100% of GDP is indicative of the frivolity with which EMU was structured.

Moreover, the Treaty and the Stability Pact provide rules relating to fiscal discipline in the EMU member states. The aim is an ex ante control of fiscal developments in each member state to prevent financial crises, adverse consequences for other member states or an overall crisis of the eurozone. Minor sanctions are imposed only for budgetary deficits and only after a lengthy process. In contrast, no sanctions are imposed for excessive debt. Of course, fiscal discipline was abolished in practice due to the politicisation of the supervision, the violations by countries such as Germany and France and the softening of the Stability Pact. In this way, countries such as Greece deviated systematically and faced almost no penalty.

Another important flaw in the design of the eurozone is the absence of mechanisms to correct imbalances and manage financial crises.[35]

As indicated above, wages and prices have to bear a large proportion of the burden of real adjustments in the context of EMU, due to the loss of monetary and exchange rate policy instruments. Wages and prices offer the necessary flexibility to make these adjustments, but they were not used for this purpose in Greece.

Asymmetries in the monetary policy of the European Central Bank (ECB) further aggravated the situation. Since Greece's inflation was constantly above the ceiling of 2%, a restrictive monetary policy was needed, with interest rates higher than those applied by the ECB. The ECB's monetary policy and low interest rates in the markets, however, functioned in a procyclical manner in Greece's case, exacerbating the deficits.

The Greek Crisis and Its Management in the EMU Context

The global financial crisis has not left Greece unaffected, even though the initial effects on the country were relatively mild. The crisis did not cause insurmountable problems for the Greek banking system, due to its relative lack of connection to the American and British systems and because Greek financial institutions had not invested substantially in "toxic" financial products. The effects on the real economy, with the exception of tourism and shipping, were also relatively mild, given the low degree of openness of the Greek economy. Thus, in 2008, the first year of the crisis, the country's GDP grew by 1.3%, while in the recession of 2009 it fell by 2.3%, one of the lowest falls in the euro area.[36] Even though the financial crisis was not the cause of the Greek debt crisis, however, it has accelerated and exacerbated it. For instance, in 2007, even before the crisis, the country had a budget deficit of 6.4% of GDP and a debt to GDP ratio of 105%. In autumn 2008, the situation became out of control, worsening dramatically in 2009, when the budget deficit exploded to 15.4% of GDP and debt to 126.8% of GDP, although there was no margin for expansionary fiscal policy.[37] Nevertheless, the country continued to borrow money on relatively favourable terms. Subsequently, a series of negative events (unrelenting negative statements about the economic situation of the country, economic policy procrastination, repeated downgrading of the country's creditworthiness by the rating agencies etc.) led to an increase in borrowing spreads, which complicated considerably the financing of the Greek public sector. This situation was exploited by speculators in securities and currency. Finally, on 23 April 2010, the country submitted a request for public funding to the IMF and the EU Council. On 2 May 2010, the decision was taken to grant Greece a loan of €110 billion (€80 billion from 15 EMU countries and €30 billion from the IMF).

This was the first time that EMU had been called upon to manage a crisis. The response was delayed considerably for several reasons, including the absence of institutionalised cri-

32 Ibid.

33 D. Malliaropoulos: How much did competitiveness of the Greek economy decline since EMU entry?, in: Eurobank Research Economy and Markets, Vol. 5, No. 4, 2010; J. Matthes, op. cit.; K. Schrader, C.-F. Laaser, op. cit.

34 P. De Grauwe: The Euro at ten..., op. cit.; J. Matthes, op. cit.

35 P. De Grauwe: The Euro at ten..., op. cit.

36 European Commission: Statistical Annex to European Economy, in: European Economy, Autumn 2010.

37 EEAG, op. cit.

sis management mechanisms, the existence of a no-bailout clause in the Treaty, the fear of creating a precedent and the reaction of citizens in some member states. The EMU countries finally approved the financial arrangement made for Greece, worried that there might be contagion effects. Indeed, a bankruptcy would have affected the national banking systems, in particular those in France and Germany, as well as the image of the eurozone and the process of European integration.

Subsequently, the eurozone has developed new crisis management tools in response to fears that other countries on the EMU periphery might also collapse.[38] These tools, in particular the European Financial Stabilisation Mechanism (EFSM) and the European Financial Stability Facility (EFSF) will be available until 2013. In December 2010 and in March 2011, the European Council agreed to amend the Lisbon Treaty to allow for the creation of a permanent mechanism, the new European Stability Mechanism, in order to ensure the financial stability of the entire eurozone. This facility will replace the EFSF and the EFSM. The agreement also provides mechanisms for restructuring the debt of heavily indebted countries through Collective Action Clauses.

The adjustment programme put in place for Greece has taken the form of a Memorandum of Understanding (MoU), subject to periodic reviews.[39] The MoU comprises an absolutely binding policy agenda, with clear commitments, a timeframe, procedures for consultation and monitoring, and other stipulations. If Greece fails to comply with its obligations under the Loan Facility Agreement and under the MoU, the lenders may cancel the Loan Facility and/or declare the outstanding principal amount of the loans to be immediately due and payable, together with accrued interest.

The Memorandum has been the cause of political and social upheaval in the country. An evaluation of it is beyond the scope of this paper. Nevertheless, it is appropriate here to demystify some dogmatic and politically opportunistic attitudes in this regard, and to this end we make the following remarks:

1. For economic, political and ethical reasons, no international loan facility can exist without assurances as to its repayment, that is without firm commitments being made by the recipient country that it will create the conditions necessary for it to reimburse the borrowed money.

38 EEAG: The EEAG Report on the European Economy, "A New Crisis Mechanism for the Euro Area", in: CESifo, Munich 2011, pp. 71-96.

39 European Commission: The economic adjustment programme for Greece…, op. cit.; European Commission: The economic adjustment programme for Greece. Second review – Autumn 2010, in: European Economy, Occasional Papers, No. 72, 2010; European Commission: The economic adjustment programme for Greece. Third review – Winter 2011, in: European Economy, Occasional Papers, No. 77, 2011.

2. The facility in question is a loan facility and not a transfer of income. It contains, though, an element of concessionality.

3. The policies stemming from the MoU are not the cause of Greek indebtedness but rather the result of long-term errors and omissions in the fields of economic and social policy.

4. The reaction to the MoU is essentially a reaction to the confrontation with economic reality, which demands that the Greek nation lives according to the productive capacity of the country. Total consumption in Greece over its ten-year participation in EMU was around 90% of GDP, with private consumption in 2009 rising to 70% of GDP; in comparison Germany's figure is 55% of GDP.[40] Domestic demand exceeded the country's GDP, while private investment fell from 20% of GDP in 2000 to 11% of GDP in 2009. At the same time, deficits in the goods and services account were consistently over 10% of GDP.[41]

5. There is an oxymoron here: the strongest reaction to the policy adjustment comes from privileged interest groups. These groups have realised that a new distribution of national income is about to take place. As a result, they may be deprived of their privileges and their ability to absorb income from other social groups and generations to come.

6. There is another oxymoron: the highly politicised state that led the country into bankruptcy must manage the crisis. The effectiveness of this approach is questionable.[42]

7. The commitments made by the Greek government in the MoU affect all aspects of government policy. Nevertheless, there was no prior comprehensive assessment of the planned interventions.

8. Fiscal and macroeconomic adjustment seems to create a vicious circle of recession. Great attention must be paid to the external aspects of development, such as increasing exports and attracting foreign investment, but also to internal factors, such as the creation of a favourable economic and political environment, the use of all available resources and the reduction of public spending in favour of public investment. Other internal factors include the privatisation of public companies and the utilisation of public property in order to finance public debt buy-backs. It will also be important to change the pessimistic psychology of the markets and society and to remedy distortions in the markets

40 K. Schrader, C.-F. Laaser, op. cit.

41 EEAG: The EEAG Report on the European Economy, "Greece"…, op. cit.

42 G. Kontogiorgis: The Greek problem: The state of occupation and the exit from the crisis, 2011, accessed on 20/01/2011 from: http://contogeorgis.blogspot.com/2011/01/blog-post_05.html#more (in Greek).

for goods and services, many of which operate with the participation of the state.

The Future of Greece: In or Out of EMU?

Since the beginning of the Greek crisis, numerous questions have been raised about the future of the country. Arguments have been made in favour of Greece's exit from EMU. In some European countries, policymakers, researchers and the public have called for the expulsion of the country from EMU.[43] Others argue that the economic and political costs of an exit would outweigh the benefits.[44] The German Finance Minister, W. Schäuble, has stated that a withdrawal from EMU would hurt not only Greece but also Germany.[45] Others have said, however, that Greece's exit would help stabilise EMU, contain the crisis and punish a country that has violated the rules of the game. Citizens in some countries have complained about having to bail out a country that lacks sound financial management. A stream of academic research also considers withdrawal (permanent or temporary) from the eurozone as the only viable alternative for Greece.[46]

In some of these cases, the opinions are misguided or even the product of plain economic chauvinism. EMU and the entire EU are based on legal rules and procedures. There is no provision in the Treaty allowing for a country's expulsion from EMU,[47] although every country has a right to return to its national currency if it wishes.

The available options are few and definite. Each is associated with both advantages and disadvantages.[48] Each contains an element of uncertainty, too. However, the prevailing view is that Greece will continue its efforts to adapt within EMU with the long-term financial support of its EMU partners and the IMF. The success will depend mainly on Greece's efforts to improve its competitiveness and growth.

Voluntary withdrawal from EMU is a risky solution.[49] By returning to its old national currency (the drachma), Greece would regain the tool of monetary policy and the possibility of issuing money in times of crisis. Furthermore, in a free, floating regime, the new drachma would experience a significant devaluation, helping to increase exports of goods and services. Greece would also be able to pursue an expansionary monetary policy. However, devaluations do not always have positive effects on exports, either because of low elasticity of export demand or because of increased costs, due to higher prices of imported raw materials and intermediate products. The adjustment of wages to inflation is another important factor that would have to be taken into consideration. On the other hand, the external debt of the country (public and private), denominated mainly in euros, would increase significantly when converted into drachmas, and the debt service would become very difficult. However, the biggest risk is inflation. The country would be very likely to enter a vicious circle of devaluation and inflation, which could degenerate into devastating hyperinflation.

Eventually, Greece's exodus from EMU would destabilise the euro area and would create an undesirable precedent with unforeseeable consequences for the future of the euro. It is in the interests of both Greece and the rest of the EMU countries to find a viable solution within the eurozone.

Concluding Remarks

Ten years after its EMU accession, Greece's experiment has proven to be almost a complete failure. What is certain is that Greece joined EMU completely unprepared. After EMU accession, Greece behaved in a manner inconsistent with economic logic and contrary to the rules of the game of a monetary union. EMU did not cause the Greek crisis. Nevertheless, the supervisory arrangements clearly failed. Furthermore, the evolution of the crisis has been exacerbated by EMU's inherent weakness in the face of asymmetric disturbances and the absence of mechanisms for early warning and rapid intervention. The responsibility for the macroeconomic imbalances within EMU lies with those who have exercised national economic policy. The inherent risks of competing against stronger economies were not unknown. However, the Greek government refused to implement the required adjustment policies, which has had destructive consequences that the country must now deal with in cooperation with its EMU partners.

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