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The Greek financial crisis and the outlook of the Greek economy ☆

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ABSTRACT

The paper consists of two parts. In the first part, a short review of the crisis in the Eurozone in 2008 and of the measures which have been taken is provided. The second part outlines the causes of the severe imbalances and high debt loads of government in Greece, which have become a threat to the country's solvency and to the stability and possibly the survival of the European Monetary Union. The paper considers the causes of the Greek crisis in order to indicate policies that would help avoid future problems in Eurozone countries facing severe and persistent fiscal imbalances. Measures taken, based on the First and Second Economic Adjustment Programme for Greece, are also reviewed. An assessment is made of the implementation of Greek Economic Policy in the context of the Euro crisis, in conjunction with the three crucial challenges that Greece faces, namely restoring growth and securing both fiscal sustainability and the financial system. The negative lessons from public sector adjustment in Greece show that positive measures must be taken.

1. Aim[1]

The paper consists of two parts. In the first part, a short review of the crisis in the Eurozone in 2008 and the measures which have been taken, is provided. The second part outlines the causes of the severe imbalances and high debt loads of the government of Greece, which have become a threat to the country's solvency and to the stability and the possible survival of the European Monetary Union. The paper considers the causes of the Greek crisis in order to indicate policies that would help avoid future problems in Eurozone countries facing severe and persistent fiscal imbalances, as well as the measures taken based on the First and Second Economic Adjustment Programmes for Greece (2010, 2012).

2. The response of the Eurozone to the crisis

The crisis which hit in the mortgage market of the USA in 2007 has since spread to the world financial system. The crisis in the banking system climaxed in September 2008 and spread to Europe. Most economies experienced negative rates of growth, unemployment rose and remains high, a number of financial giants have closed or are having severe problems, private consumption and investment have shrunk because of uncertainty and asset devaluation. This crisis is different from previous ones, mainly because of its world-wide extent and because a vicious cycle links the problems in the financial sector to the deceleration of the real economy. The return to sustained growth presupposes, inter alia, a restructuring of corporate portfolios. It is therefore difficult to establish mechanisms for coordination and return to positive growth rates.

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[1] An earlier version of the first part of this paper was partly published in Baltas (2012).

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Table 1
Financial balances in selected Eurozone and other countries (deficits % GDP in 2006–2012).

Country	2006	2007	2008	2009	2010	2011	2012
Eurozone							
Belgium	0.1	−0.4	−1.4	−6.1	−4.9	−4.5	−3.6
France	−2.3	−2.7	−3.3	−7.6	−7.4	−6.1	−4.8
Germany	−1.6	0.3	0.1	−3.0	−4.0	−2.9	−2.1
Greece	−3.9	−5.4	−7.8	−13.7	−8.3	−7.6	−6.5
Ireland	2.9	0.0	−7.3	−14.3	−32.3	−9.5	−7.4
Italy	−3.3	−1.5	−2.7	−5.2	−5.0	−3.9	−3.1
Netherlands	0.5	0.2	0.5	−5.4	−5.8	−4.0	−3.1
Portugal	−4.1	−2.8	−3.0	−9.4	−7.3	−5.0	−4.4
Spain	2.0	1.9	−4.2	−11.1	−9.2	−6.3	−4.4
Non-Eurozone							
UK	−2.7	−2.8	−4.8	−11.0	−9.6	−8.1	−6.5
Sweden	2.2	3.5	2.2	−1.2	−1.2	−0.6	0.6
Norway	18.5	17.7	19.3	9.9	9.5	8.7	8.8
Switzerland	0.8	1.7	2.3	1.2	−0.7	−0.4	0.0
Japan	−1.6	−2.4	−2.1	−7.1	−7.7	−7.5	−7.3
US	−2.2	−2.9	−6.3	−11.3	−10.5	−8.0	−6.8

Source: OECD (2010a), Economic Outlook, No. 87, May; OECD (2010b) No. 88, November.

Table 2
Financial balances in selected Eurozone and other countries (debt % GDP in 2006–2010).

Country	2006	2007	2008	2009	2010
Eurozone					
Belgium	91.3	88.0	93.2	100.1	103.0
France	70.9	70.0	76.1	86.4	92.0
Germany	69.4	65.0	69.0	78.2	80.0
Greece	107.9	105.0	102.6	114.9	129.0
Ireland	28.8	29.0	48.5	70.0	105.0
Italy	117.2	113.0	114.5	122.9	131.0
Netherlands	53.9	52.0	64.6	69.5	75.0
Portugal	73.1	69.0	75.2	87.0	93.0
Spain	42.0	42.2	46.8	58.4	72.0
Non-Eurozone					
UK	46.0	47.0	57.0	75.3	81.0
Sweden	50.3	47.0	44.0	52.0	51.0
Norway	60.5	58.4	56.0	59.9	59.0
Switzerland	50.3	46.0	44.0	44.4	42.0
Japan	172.1	167.0	172.1	189.6	198.0
US	60.8	62.0	70.0	83.9	93.0

Source: OECD (2009), Economic Outlook, No. 85, June; OECD (2010a), No. 87, May; OECD (2010b), No. 88, November.

Although the collapse of markets and economies has been avoided in the year 2010, the credit risks as a result of excessive deficits[2] remain at exceptionally high levels. The global financial crisis has shown fundamental weakness in the fiscal and monetary policies in the Eurozone. The sovereign debt[3] crisis in the euro area and the real economy during the spring of 2010 has revealed that the monetary and fiscal policy framework of the European Monetary Union (EMU) is still incomplete. It quickly became obvious that the rules-based framework for fiscal policy created by the Excessive Deficit Procedure (EDP) and the Stability and Growth Pact (SGP) when the EURO was introduced was insufficient to prevent a debt crisis despite its emphasis on keeping public sector deficits low and strengthening forward-looking budgetary planning, because it did not include arrangements for appropriate means to prevent and correct imbalances.

The questions I will attempt to answer with respect to the current economic crisis and methods of management thereof, include, among others, the following:

[2] Table 1 presents the situation regarding deficits in selected Eurozone and other countries in the period 2006–2012. The first observation is that financial balances deteriorated in the Eurozone in the aftermath of the Global Credit Crunch (2007–2008). Second, the deficit limit of 3% was not respected (and no sanctions applied). Third, Ireland had a balanced budget in 2007, while its deficit soared to over 32% of GDP in 2010. Fourth, the UK (not a Eurozone member) strongly increased its deficit from 2006 to 2009 and has since kept it on a relatively high level. Fifth, countries that are outside the Eurozone (Sweden) and outside the EU (Norway and Switzerland) apply the stability and Growth Pact criteria in an exemplary way. This implies that Swiss direct-democracy political system exercises control on government expenditure more effectively than the alternative systems (Jovanovic, 2012).

[3] Table 2 presents the situation regarding debt in selected Eurozone and other countries in the period 2006–2010. Debt in the Eurozone countries increased. There are several striking features. First, the non-Eurozone (Sweden) and non-EU member countries (Norway and Switzerland) apply the Maastricht debt criteria in an exemplary way. Second, the UK doubled its national debt in just three years following 2007. Ireland more than tripled in the period 2007–2010 (Jovanovic, 2012).