Why Greece is a Victim of the Debt Crisis

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The global financial crisis and global recession have remarkably influenced the overall economic development in Greece.

The paper analyzes the main factors which contributed to the present unsustainable level of public debt in Greece. Based on historical data since the creation of the European Monetary Union Greece was not able to fullfill all necessary requirements to be a member of euroarea. Poor management of public finance, slown progress in structural reforms, loss of competitiveness, including the misreporting of the main statistical data on economic development, are the main factors which significantly contributed to the present level of fiscal unsustainability.

In line with analysis of the adjustment programs, the paper came to the conclusion that poor political commitment to the first stabilization program, including the failure of implementation of both the performance criteria and the benchmarks are the main factors behind the failure of the first Stand-by-Arrangement provided by „Troika“ e.g. European Commission, European Central Bank and the International Monetary Fund.

JEL Classification: H61, H63, H63
Keywords: fiscal deficit, public debt, sustainability of public debt

Svetová finančná a hospodárska kríza výraznou mierou ovplyvnila ekonomický vývoj v Grécku.

Článok analyzuje hlavné faktory, ktoré viedli v súčasnosti k neudržateľnosti verejného dlhu Grécka. Na základe historických údajov Grécko nebolo schopné splniť kritéria členského štátu eurozóny od vzniku Európskej menovej únie Nezodpovedné riadenie verejných financií, slabý pokrok v štrukturálnych reformách, strata konkurencieschopnosti, vrátane poskytovania skresľujúcich štatistických údajov o vývoji gréckej ekonomiky sú faktory, ktoré významne prispeli úrovni neudržateľnosti verejných financií.

Článok na základe analýzy stabilizačných programov dospel k záveru, že nedostatočný politický záväzok k prvému stabilizačnému programu, vrátane zlyhania pri plnení „performance criteria aj benchmarkov“ sú hlavnými faktormi prvého neúspešného stabilizačného programu „Stand-by-Arrangement“ medzi Gréckom a Európskou Komisiou, Európskou centrálnou bankou a Medzinárodným menovým fondom.

Klasifikácia YEL: H61, H63, H63
Kľučové slova: fiškálny deficit, verejný dlh, udržateľnosť verejného dlhu

Introduction

The creation of the European Monetary union was an unprecendented step in finalizing the main ideas in reaching the final stage of the European Community (EC). The Rome Treaty set up the very ambitious goal focusing on liberalizing trade and services, free movement of labor and capital, including the creation of the single European market in the old continent. The latest and most difficult step in finalizing the main goal of the Roma Treaty was to establish a common currency for the member countries of the European Community.

Greece joined the EC in the early 80s and became the tenth member in this community. According to modern economic history, Greece did not belong to the core countries, which created the EC. However, at the beginning of the entrance to the EC, Greece had a relatively stable economy. Nevertheless, later Greece, as a member country of European Union (EU), did not reach all the necessary nominal convergence criteria for the euro adoption. Therefore, the strategy for euro adoption in Greece was postponed due to not fulfilling all the requirements. Despite this discouraging economic performance of the Greek economy, the EC opened the door to adoption of the single currency.

Since the beginning of euro adoption, the Greek authorities were not able to fulfill nominal convergence criteria, mainly in the area of fiscal policy. Greece permanently breached the main principles in terms of Stability and Growth Pact (SGP)[1]. In line with the outbreak, the global financial crisis and the recession, the Greek economy was fully hit by these real external shocks. The Greek authorities did not save an appropriate amount of money during the good years, as is mentioned in the SGP. This led to fiscal unsustainability. Therefore, the Greek authorities applied for the stabilization program with the Troika[2]". The first stabilization program between the Greek authorities and Troika was approved in May 2010. However, this program was only marginally successful. Therefore, the Greek authorities applied for an additional stabilization program with Troika in 2012.

Historical overview of the Greek fiscal deficit

Greece's authorities did no follow the basic rules in the SGP. The fiscal stance since the creation of the EMU was less encouraging. As Table 1 clearly shows, the Greek authorities were not able to fulfill the main nominal convergence criteria for fiscal deficit. The only exemption was year 2006 when the general public deficit was below 3 percent. The table demonstrates that the Greek authorities permanently have broken the main rules for fiscal deficit set up in the SGP[3]. .

Table 1 Actual fiscal deficit

Actual fiscal deficit from 1999 to 2009 (in % of GDP)												
Year	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Eurozone	-2.3	-1.4	0	-1.9	-2.6	-3.1	-2.9	-2.5	-1.3	-0.6	-2	-6.3
Greece	n/a	-4.5	-3.7	-4.5	-4.8	-5.7	-7.5	-5.2	-2.9	-3.7	-7.7	-14

[1] Článok je súčasťou výskumného programu VEGA „Fiškálna a menová politika a jej vplyv na podnikateľské prostredie".
[2] The first stabilization program between the Greek authorities and Troika was approved in May 2010.
[3] For the relatively very poor performance on the fiscal side were responsible both the Greek authorities and competent officials in the European Commission who did not adopt appropriate measures in line with the main principles as set out in SGP.

Source: Table set by the author by using data from the second Stabilization program
Fiscal deficit was more than twice higher, e.g. in 2004. This is one of the main factors that remarkably contributed to the present stage of fiscal unsustainability

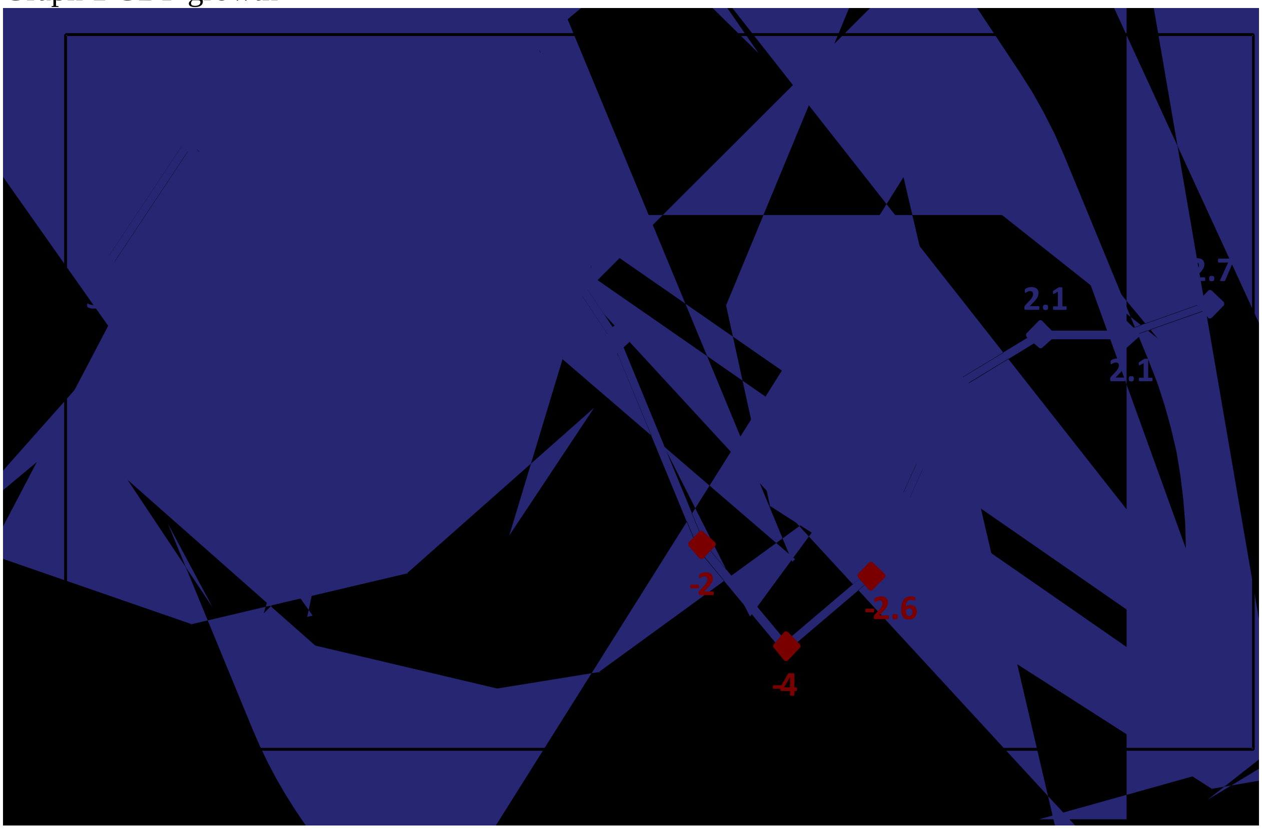
Greece's first Stabilization program with Troika

At the end of 2009 and at the beginning of 2010, overall economic situation in Greece significantly deteriorated. Risk premium (spread) on the government bond reached an unprecendently high level. Greece lost access to the international capital markets. Therefore, the Greek authorities asked Troika for a stabilization program. The program prepared by "Troika" was based on a standard approach of the IMF conditionality[4].
The main goal of program was to stabilize the Greek economy, to reduce the threats of fiscal unsustainability and to create conditions for stable economic growth.

Increasing economic growth

The comprehensive stabilization was focused on stabilization of public finance and creation of conditions for recovering competitiveness of the Greek economy. One of the key elements of the program was economic performance (see Graph 1).

Graph 1 GDP growth



Source: Graph set up by the author based on data from the first Stabilization program

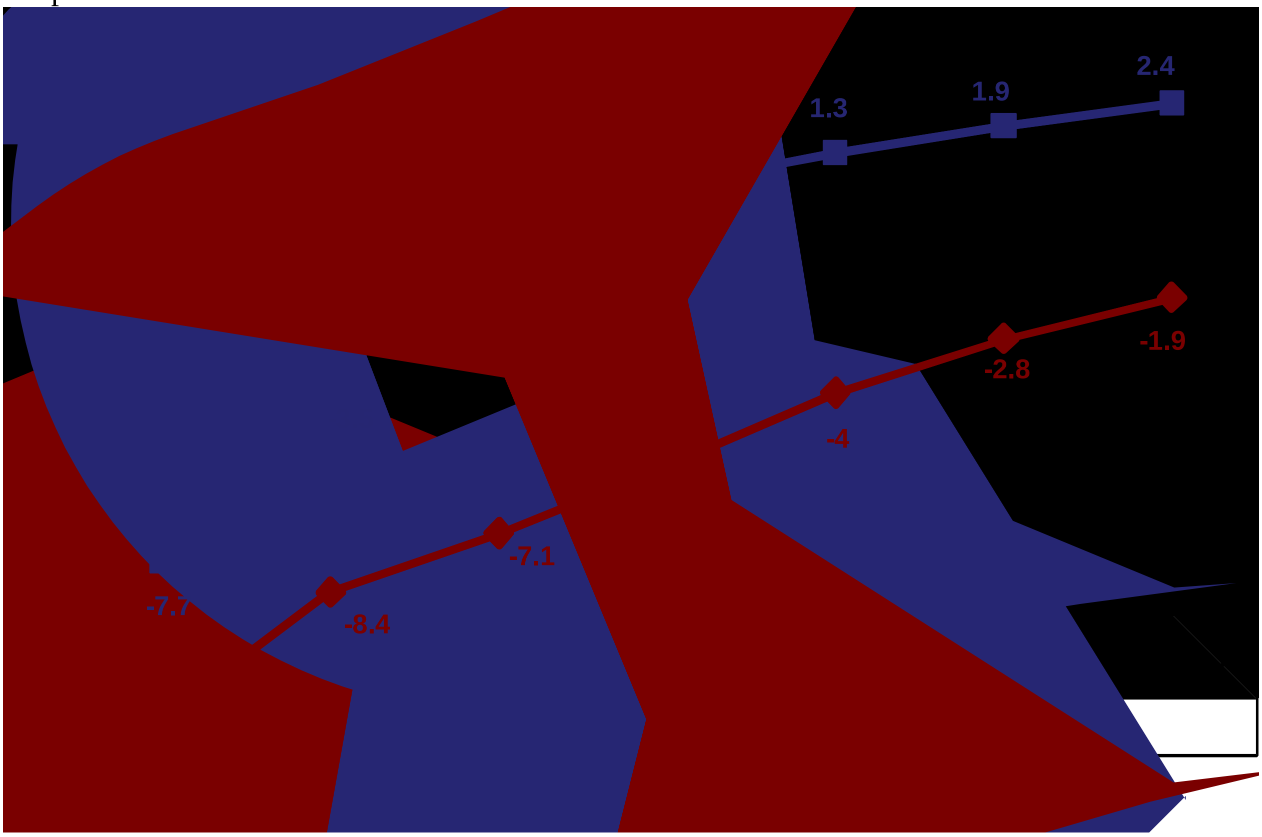
[4] Under the IMF conditionality, it means that the applied country should fulfill all necessary criteria. Under the stabilization program between the Greek authorities and Troika were set out both performance criteria and benchmarks.

Based on results of the adjustment program, its performance was disappointing. According to the program, it was expected that Greek economic growth will be positive at 1.1 percent in 2012. However, due to poor political committment and poor leadership of the Greek authories, the program was not successful.

Current account position

Stabilization program concentrated also on the external position. Therefore, Troika figured out that in order to put the economy on a sustainable path, an increase in the competitiveness of the Greek economy was critical. In line with this strategy, the stabilization program focused on export side of the economy (see Graph 2). The main idea was that economic growth will be driven by export performance.

Graph 2 Current account and trade balance



Source: Graph set up by the author based on data from the first Stabilization program

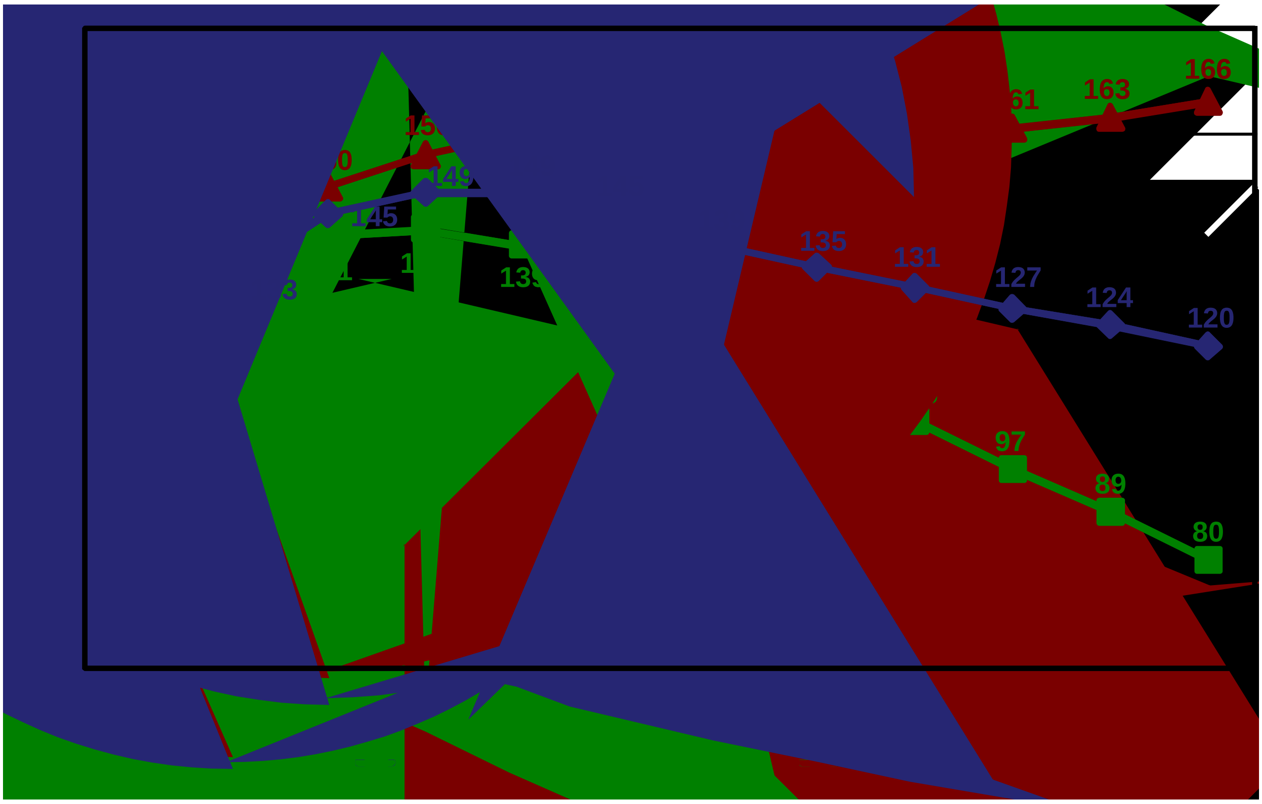
Based on this program, it was expected that the external position (current account) in 2012 would be positive at 0.6% of GDP. The negative trade balance which reached a peak during the global recession in 2009 (-11.2% of GDP) was expected to reduce to 7.6% of GDP in 2011. In preparing the stabilzation program, Troyka emphasized that reducing public debt was essential. In line with this, a very comprehesive plan was prepared for reducing public debt and gradually maintaining sustainability of public finance. Therefore, Troyka prepared three scenarios: optimistic, real and pesimistic until 2020.

The first scenario (optimistic) was based on assumption that the annual economic economic growth within the whole dacade will be 1%. Under this scenario, it was expected that the public debt would reduce to 80% of GDP in 2020[5].

The second scenario was based on the assumption that economic growth until 2020 will not change in this time schedule. Based on this expectation, the public debt will reach approximately 120% of GDP in 2020.

The third scenario was a pessimistic[6] one. This assumption was based on the expectation that the economic growth will continue stagnation for the whole decade. Based on this pessimistic expectation, public debt was expected to reach 166% of GDP in 2020.

Graph 3 Three scenarios of GDP growth and public debt



Source: Graph set up by the author based on data from the first Stabilization program

Greece's second Stabilization program with Troika

Despite the fact that between the Greek authorities and Troika a very comprehensive adjustment program was adopted for putting the economy on sustainable path, the

[5] Based on this very ambitious assumption, Greece will not reach nominal convergence criterion of 60% of GDP that was set up for public debt under the Maastricht Treaty.
[6] Altghough this scenario was pessimistic, it is now the more realistic one.

performance of the program was not encouraging. Therefore, the Greek authorities made a request for the second stabilization program with Troika[7].

The second program followed the poor economic performance and lag of political committment of the first program. Instead of preparing a Stand–by Arrangement that was adopted as a first stabilization program, the second stabilization program was adopted under the very complicated environment in the global economy, but in particular, in the economy of eurozone[8]. Table 1 clearly demonstrates that instead of improving the fiscal sustainability, public debt significantly deteriorated during the first stabilization program. There was also an expectation that for improving of the revenue side, privatization receipts would be helpful. However, this criterion was not reached. In addition, it is clear from the table that public sector debt to revenue ratio was significantly growing. The most critical for assessing the solvency of the Greek economy is the big financing need during the presented period in this table.

Table 1 Actual baseline projection for public debt (2007-2011)

	Actual				
	2007	2008	2009	2010	2011
Baseline: Public sector debt	107.4	112.6	129	144.5	165.3
Change in public sector debt	0.1	5.2	16.3	15.6	20.7
Privatization receipts (negative)	0	0	0	0	-0.5
Public sector debt-to-revenue ratio	263.3	276.8	339.2	366.1	403.1
Gross financing need	6.8	9.9	15.8	19.4	26.6

Source: Table set by the author by using data from the second Stabilization program

In line with the second stabilization program between the Greek authorities and Troika, the baseline scenario for public debt was prepared (see Table 2). According to this scenario, the public debt will grow until 2014, when it will reach 171.2% of GDP. From this projection, it is expected that public debt will gradually reduce to 110% of GDP in 2030. Based on this projection, there is an expectation that the privatization receipts will be very important for stabilization of public debt. There is also a positive sign in terms of a gradually reducing ratio of revenue to public debt, which is still very high in 2030.

Table 3 Baseline projection for public debt (2012-2030)

	Projections									
	2012	2013	2014	2015	2016	2017	2018	2019	2020	2030
Baseline: Public sector debt	161.7	169.4	171.2	170.5	168	162.8	157.5	151.7	145.7	110
Change in public sector debt	-3.6	7.7	1.8	-0.7	-2.5	-5.2	-5.2	-5.8	-6	-1.7
Privatization receipts (negative)	-0.5	-1	-1	-1.6	-1.7	-1.7	-1.2	-1.3	-1.3	0
Public sector debt-to-revenue ratio	386.6	403.5	405.7	417.9	411.8	399.1	386.3	371.9	357.3	269.7
Gross financing need	34	12.9	14.8	11	9.7	8.3	4.9	6.6	6.9	12.9

Source: Table set by the author by using data from the Second Stabilization program

[7] The second stabilization program between the Greek authorities and Troika was approved in March 2012.
[8] Negotiations for the second stabilization program between the Greek authorities and the Troika was at the same time as the debt crisis in the eurozone started to become the main problem in the world economy. This problem was also connected with the stability of the financial sector as a whole.

Since public debt to GDP will be relatively very high in 2030, the additional financial sources will be needed for covering the financing needs.

Conclusion

The outbreak of the global financial crisis and recession signicantly deteriorated the overall economic indicators of the Greek economy. Based on historical overview, since the preparation of euro adoption, the Greek authorities were not able to stabilize public finance. Due to poor political commitment to the structural reform agenda and loss of competiveness in the past, the Greek economy was hit strongly by external real shocks.

Therefore, the Greek authorities requested a stabilization program with the European Commission, European Central Bank and International Monetary Fund. The adopted program based on conditionality was not successful. The main reason for the failure of the adjustment program between the Greek authorities and Troika was poor political commitment to the program itself. Therefore, the Greek authorities requested for th second stabilization program with the Troyka.

At this stage of development, it is very difficult to predict the outcome of the second stabilization program. However, one thing is clear – reducing public debt in order to get the nominal convergence criterion under 60% of GDP is a long-term challenge for the Greek authorities. The question is whether the Greek authorities will be able to do it without strong support of citizens of Greece.

The lesson as to what might be learned is clear. If there are good years, it is necessary to save for bad years. Do do this, a comprehensive structural reform strategy, including the authorities‘ committment should be put in place.

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Second Stabilization program between the Greek authories and Troyka (EC, ECB and IMF).