CHAPTER II

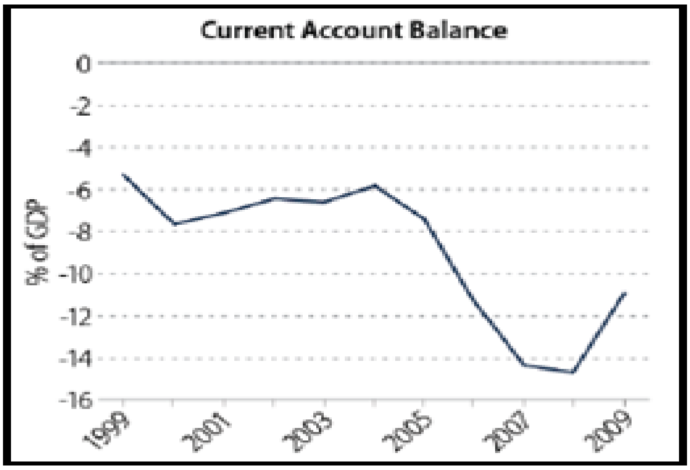
GREECE ECONOMIC CRISIS

This chapter will analyze Greece economic crisis. This will give further information about Greece integration toward European Union which triggered the crisis. It shows three main causes of the crisis which are the widespread of corruption, inefficient administration, and continuous fight with public deficit. The crisis determines consequences on the economic and political stability which pushes the government and European Union to response to solve the problem by establishing Troika.

A. Greece Crisis

A state could be defined as debt crisis when the state is unable to pay loans. When the global financial crisis happened, Greece spent more money to support the economy stability. Greece spent more money than Greece used to, it made the loans getting bigger from what Greece expected. It happened to Greece. Since 2009, Greece economic crisis has been beyond the national economic crisis because the Greece crisis gave contribution within the European Union and disturbed the stability, future, and integrity among the member countries to the world. Greece became the first member of European Union which faced the crisis. The crisis gave the domino effect to the other membercountries such as Spain, Portugal, Ireland, and Italy. Dealing with the worst economic condition comparing with the other European Union members, Greece crisis became serious concern of European Union. Greece debt crisis was marked with the downgraded of credit rating by the big rating agency; Fitch. Greece announced that the deficit reached 12.9% of total Gross Domestic Product (GDP) or it was more than 3% limit mandated from the European Union (Amadeo, 2016). Greece financial problem actually began before Greece integration within European Union.

Figure 2.1.Greece's Current Account Deficit 1999-2009



Source: Rebecca M. Nelson. *Greece's Debt Crisis: Overview, Policy Responses, and Implications*. Congressional Research Service, August 18, 2011 page 4

B. Greece within European Union

1.The Integration of Greece toward European Union

European Union is a supranational organization established after the World War II in 1951 with the purpose of creating peace and prosperity in Europe. The establishment of European Union started with the establishment of

European Coal and Steel Community (ECSC). In 1957, the ECSC changed into the European Economic Community (EEC). After that the EEC became European Union until now. European Union is the regional institution which has strongest binding integration comparing to other institutions.European Union evolved from the trade institution into economic and politic cooperation. European Union has unique bureaucratic system withits own flag and the implementation of single monetary system controlled by the European Central Bank.

The integration of Greece toward European Union was through complexway. It was started in 1961 when Greece for the first time proposed the state for the accession within European Economy Community through Athens Agreement but it was not implemented because of the dictatorship regime for about seven years. Greece decided to apply for the full membership to the EEC in July 1975 and successfully became the tenth member of the European Economic Community later as European Union in 1981 after the collapse of the dictatorship regime.

Greece as a special unique country integrated to the European Union since Greece's characteristic of the peripheral state has lower economic development and industrialization, low standard of living within Europe, and the historic heritage of the Ancient Greece (Larsen & Olsen, 2010).

The effort of Greece toward the integration of European Union was not yet over after the accession of Greece within the European Community.The political instability in line with the changing political party gave impact to Greece including in the economic stability. Before the full membership accession in 1981, Greece was ruled by ND party oriented to the European Union integration. After 1981, PASOK as the opposition party won the election and changed the foreign policy.

Greece had difficulty for adapting in the industrial market competition with the other European Union member countries especially north Europe. It made the decreasing of Greece GNP.1985-1995 was the unexpected time because European Union tightened the integration rules in every sector and the expansion of acquiscommunautaire namely Schengen Treaty (1985), Single European Act (1987), and Maastricht Treaty (1992) (Valinakis, 2012).Unfortunately, Greece became the only country which could not fulfill the requirement according to Maastricht Treaty.

The Treaty of European Union (TEU) was signed in Maastricht on February 7th, 1992 and came into force on November 1st, 1993. Maastricht Treaty illustrated five joining criteria in which European Union member countries are required to comply to adopt new single currency of the euro and Economy Monetary Union (EMU). The reasons for setting those criteria are for preparing the European Monetary Union and introducing elements of political union (citizenship, common foreign and internal affairs policy).

The five criteriabased on article 121 (1) provided on Maastricht Treaty are a) price stability, consumer price inflation rate could not be more than 1.5 percentage points above the rate of the three best member states performance over the previous year; b) sound public finance, government budget deficit could not be more than three percent of the gross domestic product (GDP); c) sustainable public finance, national public debt could not be more than 60 percent of the gross domestic product (GDP); d) durability of convergence, long term interest rate should be more than two percentage points above the rate of the three best member states performance in term of price stability; e) exchange rate stability, the national currency is required to participate in exchange rate mechanism (ERM) II for at least two years without severe tensions("Who Can Join and When?", 2015).

However, the inflation, budget deficit, debt, and high interest rates along that time made Greece unable to join the European Union as full membership. It triggered Greece for being part of the member by various austerity programs which gave significant result. In 2001, Greece finally could fulfill the requirement by inflation 2.1%, and budget deficit for 1.7% of the GDP or under 3% from the Maastricht criteria(Gurzel, 2004).

2. Greece After Integration

All the rough and long integration effort for Greece was paidafter the approval on joining as the full membership on European Union implementing the single monetary system. In the beginning of 2002, Greece changed their currency from Drachma into Euro. European Union showed the abilities creating modernization in form of political stability and realizing democracy, changing state society relation, and creating modern civil society.

The Greece integration within European Union changed the economy system. First, the state reduced some economic activities. The adoption of the criteria was used to apply the macroeconomic discipline. Its purpose was to reduce public deficit, public debt, interest rates, and achieve monetary and fiscal activities. Implementing the European norms and requirements of the Union, Greece reduced the budget deficit and privatized state companies. Second, the Greek economy regulatory pattern from protectionist policy into the European one conformed with Europeans regulation practices. The private economy and liberalization of Greek banking system were strongly centralized and tightly controlled by state. The European regulation gave more space for economic activity and competition. Greece has gotten stable foreign image and more direct investment from the European Union (Larsen & Olsen, 2010, pp. 10-14).

Although Greece made significant changes both in society and state functions, Greece ran into controversy. Since 2003, European Union found thirty cases violated fiscal rules on bringing up the stability and growing pact toward the members including Greece. By the case, European Union addressedformal warningto Greece which was accused in violation deficit and debt limits on joining Eurozoneand forced them to consolidate public finance (Nelson, 2011). Greece falsified the data of budget deficit which actually reached 8.3% higher regarding what it should be only 3%. The Olympic Games in 2004 held in Greece spent much cost. The new government of Karamanlis tried to force austerity budget to cut the budget and got finance back. Despite revealing the real deficit that Greece falsified and started to deal with, Greece government covered it. However, what Greece did triggered the recession. After the global financial crisis blew up in 2008, Greece national budget deficit rose reaching €262 billion from

€168 in 2004. In 2009 Fitch rating announced the Greece credit rates were below the investment grade. The downgraded credit ratingfrom A- to BBB+ was also as mark on Greek depression for the first time("Timeline of a Crisis", 2011).

C. The Causes of Greece Crisis

Greece actually had interesting investment power.However the crisis triggered investor to distrust toward the financial sector. The Greece crisis led the dramatic increase on budget deficit and trade deficit.The Greece budget national deficit reached to €262 billion from €168 billion in 2004. The global financial crisis thathappened worsened the Greece economy condition beside some internal factors such as widespread of corruption, inefficient administration and not motivated employees, and continuous fight with public deficit.

1. Widespread corruption

The spreading of corruption within Greece affected the business environment and distorted market competitiveness. A common form corruption in Greece was from the small to the higher officials or other recipient in form of bribery to get some benefits. The ineffective implementation of law existing in both active and passive bribery, abuse of office, and money laundering worsened the corruption both in higher and lower position in the government. Tax administration and public procurement were the most sector identified for corruption. Tax evasion was as the result of huge shadow economy. Although there have been rules and laws to criminalize, yet gifts, bribery, and facilitation of payments spread widely. The institutions which were famously contaminated with the corruption are judicial system, police, public services, land administration, tax administration, custom administration, public procurement, natural resources, legislation, civil society, etc.

2. Inefficient administration and not motivated employees

The economy problem of Greece actually began before the integration within European Union. Greece falsified the administration to erase the public deficit and inflation to meet the requirement of standard of Eurozone debt to GDP ratio. In 2004 the changing government which had opposite ideology covered up the problem instead of revealed the truth. The government yet loaned more money for Athen's Olympic. Thus, it worsened the Greece debt which reached 160% to GDP within ten years. The lack of governance system which did not have good control coordination and mechanism became the core of the Greek government incompetence (Chih-mei, 2015).

The high wages of the employees were opposite with the significant increasing of the employees performance determined the incompetitiveness and increased the current account deficit. Greece got a bad rank in the institutions quality on the 15th position among the sixteen European Union members and it was getting worse since 2006. The entrepreneurs of Greece also had bad attitude. They only concerned about their money and would do anything to get money yet exploited other people's work. Greece had high degree of difficulty for starting business because of the bureaucratic obstacle namely corruption. The lack of Greece credibility and efficiency were the reason of the failing debt effectiveness and management.

3. Continuous fight with public deficit

Greece had the best economic growth within Europe continent since 1950s to 1970s. The fluctuation of Greece economic condition actually began since 1980s for the weak growth and increasing annual budget deficit. It was also because of the European Monetary Union entry impact. Greece entered EMU which had two fundamental weaknesses. First, the debt to GDP highly affected the growth prospect and severe limitations on fiscal policy. Second, the determining fiscal outcome by institutional fiscal framework was weak based on the lack of budget preparation, numerical fiscal rules, and independent assessment.

The evolution of political regime affected the lending system which was before 1980s, the external lending was made for investment purposes. Then, after 1980s when the socialist ruled the government and state, the situation completely changed. The increasing loan because of the over consumption finance in effort to raise living standard of Greece led to the current account deficit and government budget deficit.Those became the main sources of the dramatic Greek economy problem. The debt in the end 1980s reached 80% to GDP until the political turmoil period in 1993 and had steady debt of 110% to GDP ratio when the government took in force to fulfill the Maastricht measurement. In the beginning 2000s, the high economy growth rate was as mark of the falling of debt per GDP continued with major infrastructure building to facilitate the 2004 Athens Olympic Games. In 2007, it showed the dramatic increasing of loan resulted to the rise of debt to GDP for 130% (Nelson, 2011).

The integration of Greece within European Union in which Greece had to follow the rules and policy especially on single monetary system pushed the Greece government to work harder. Greece as the peripheral country was difficult to improve their trade balance, increase the GDP, and increase the export. This condition was opposite with the developed country which was easy to adapt with the system. The interdependency and interconnection of the different culture and condition will make the weak one being weaker. When the member countries share the same currency system, the strong member will get more benefits on the financial system while the weak one will get economic disturbance.

D. The Consequences of Greece Crisis

1. Economic Stability

Greece crisis affected the stability of Greece condition, Eurozone, and global financial system as well. The Greece crisis triggered the great recession, structural weaknesses in the Greece economy, banks closure, and sudden crisis in confidence among lenders. It also made Greece suffered fromthe worst GDP, the significantly increasing unemployment, shuttering shops and the bankrupt of the companies as the impact of mass money withdrawal.

Greece sovereign debt crisis which became the worst economy crisis among the European Union members triggered the Eurozone crisis. Greece crisis contributed to the other European Union memberscrisis as the domino effect such as Spain, Portugal, Ireland, and Cyprus. Euro as single currency system fell drastically.

The economy sinking of Greece gave impacts to the global financial system especially on the export stability, banks and investors bond with the Greece. The global stocks market was shaken. Many states which had trade cooperation automatically got the influence of the crisis.They lost the amount of the exports. Banks and investors bond with Greece were harmed and they decided cutting off the cooperation. However, some banks and investors which continued the cooperation regretted their decision after the worsening Greece crisis. Fortunately Greece has repaid the losses to them through ECB, IMF, and other Eurozone states well known as Troika (Samuelson, 2015).

2. Political Stability

The Greece crisis which happened gave influence to the political stability through the complicated swinging of political party and ideology. The society which felt the crisis impact susceptibly had chaos and conflict because of the untrust toward the government. The crisis determined the lack of democracy on finding the crisis solution and worrying the future of the Greece.

There were two big parties being the majority on parliamentary which were Panhellenic Socialist Movement (PASOK) and New Democracy (ND). PASOK with the centre-left ideology ruled the country in 1981-1989, 1993-2004, 2009-2011. While, ND with the centre-right ideology ruled during 1990-1993, and 2004-2009. ND had bad image from the society because the party brought the country to the crisis and criticized party’s credibility. On the other side, PASOK brought the country to be more neo-liberal in 2009 which gave solution toward the crisis through the European Union offering which was the austerity. The PASOK programs became controversion since it was against their ideology, past political practice, and historical party course. Later, the programs implemented by the society harmed the society. Unfortunately, both parties were lack of ideas, policies, management, and vision to solve the crisis (Lyrintzis, 2011).

E. Crisis Response

Since the late 2008, the significant fiscal problem spreading boosted the worries among the other Eurozone peripheral states because of the absence of the Eurozone big institutions which should absorb shocks and develop uncertainty about theinterpretation of EU non-bailoutstatement and eagerness of Eurozone members supporting the weaker members and the single currency system that is Euro. The problem got worse because the peripheral members strongly depended on external capital and interlinkages between the government and banks. The peripheral members confronted with capital inflows suddenly stopped and strongly tightened of financial condition for elites, banks, company, and households as intra Eurozone capital flows fell sharply.

The European Union offered immediate response and long term response. Temporary assistance mecchanism as the immediate response in form European Union took a quick movement on raising bilateral loans between the European government and European Commission. The European Union also created contemporary funds which were European Financial Stabilization Mechanism (EFSM), and European Financial Stability Facility (EFSF). The efforts of the European Union became the evidence on high solidarity among the members.

Helping to prevent a reoccurance of future crisis and creating permanent facilities were the aim of the long term response. Ensuring public finances, ensuring competitiveness and promoting growth became the long term response from the European Union. Commitment to bring the health financial system would be monitored by the Stability and Growth Pact. There would be strict monitoring to verify that the country would fulfill budget target. Despite ensuring public finances, ensuring competitiveness and promoting growth were the other key approaching the crisis response. New monitoring instrument on economy policy adoption had been established to ensure the competitiveness and promote growth. The new monitoring instrument also had purpose to avoid damaging bubble on housing market. Considering the worse problem and preventing worsen crisis, ECB played the important role for it. Looking for the future if the crisis continued, European Union established Troika as the last way healing the economy crisis ("Responding to the Debt Crisis", 2014).