

CHAPTER II

THE DYNAMIC OF GREECE ECONOMY

Economy is the most crucial aspect that could represent the prosperity of the people within the nation. However, known as the developed country, Greece had recently declared its bankruptcy in 2010. In order to understand the issue, this chapter will explain the economy groundwork of Greece from its structure, growth, external relations, and its basic foundation.

A. The Economy Structure of Greece

Greece has a capitalist economy with a public sector accounting for about 40% of GDP and with per capita GDP about two-thirds that of the leading euro-zone economies. The capitalist economy is driven by business investment and businesses only invest with a view to making a profit. Like the majority of European countries, Greece is a developed country with a primary economy based on the service sector as it contributes 82.8% in 2017. This sector includes professions, such as street vendors, hotel and lodging industry, public administration and telecommunications. With tourism right at the helm, the service sector has overtaken all other sectors in terms of contribution to the GDP. According to the 2009 data, Greece service sector employed 65.1% workforce (Anonymous, Wikipedia).

The contributions to the amount of GDP are also obtained from the industrial sectors as the secondary economy based of Greece which contributes almost 20.8% of the national GDP and employs 22.4% workforce. As Greece is a mountainous region, Athens is the only city with the maximum concentration of industries. The reasons vary from connectivity to ease of transportation. The various Greece industries include mining, petroleum,

food and tobacco processing, metal products, textiles and chemicals.(Content, 2010)

Beside those, the agriculture sector which is the tertiary sector of Greece also contributes to Greece's GDP by approximately 3.4% and absorbs 12.4% of the country's work force. However, due to shortage of natural resources and cultivatable land, Greece is not able to grow its production volume significantly. The main agricultural products are wheat, barley, sugar beets, corn, wine, tobacco, olives, tomatoes, potatoes; beef and dairy products. Out of all agricultural products, olive oil is the topmost contributor to national export besides other fruits.

The Gross Domestic Product per capita in Greece was last recorded at 18,945 US dollars in 2017. The GDP per Capita in Greece is equivalent to 180 percent of the world's average. GDP per capita in Greece averaged 19053.43 USD from 1980 until 2017, reaching an all time high of 32,198 USD in 2008.(Anonymous, Greece - Gross domestic product per capita in current prices).

B. The Growth of Greece Economy

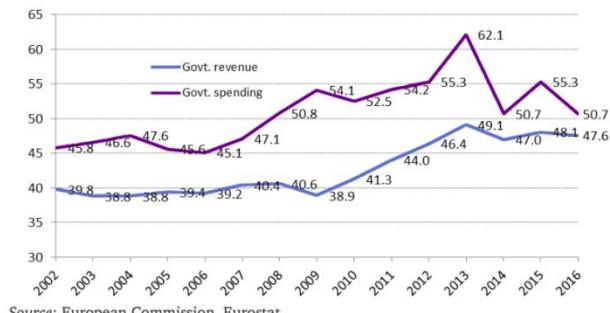
Greece was classified as an advanced, high-income economy, and was a founding member of the Organization for Economic Co-operation and Development (OECD) and of the Organization of the Black Sea Economic Cooperation (BSEC). The country joined what is now the European Union in 1981. In 2001 Greece adopted the euro as its currency, replacing the Greek drachma at an exchange rate of 340.75 drachmae per euro. Greece is a member of the International Monetary Fund and of the World Trade Organization, and ranked 34th on Ernst & Young's Globalization Index 2011.

The Greek economy averaged growth of about 4% per year between 2003 and 2007, but the economy went into recession in 2009 as a result of the world financial crisis, tightening credit conditions, and Athens' failure to

address a growing budget deficit. By 2013 the economy had contracted 26%, compared with the pre-crisis level of 2007. Greece met the EU's Growth and Stability Pact budget deficit criterion of no more than 3% of GDP in 2007-08, but violated it in 2009, with the deficit reaching 15% of GDP. The instability of the Greek economy resulted in uncertain economic growth. The most drastic decline occurred in 2009 as Greece, through its economic minister, George Papaconstantinou, announced that Greece had a deficit of 13%. (Anonymous, Greece Economy 2017).

The Greek government was keen to encourage a strong economy—at least in terms of growth rates—to woo investors and, for political purposes, to bring about convergence to the high standards of living enjoyed by the most developed of the Eurozone's countries, such as France, Germany, and the Netherlands. Growth at this pace was unsustainable, however; it was more akin to a binge, particularly in respect to credit growth, wage growth, and the big increases in public spending. Rather than creating the conditions for sustainable growth, the government was encouraging a bubble to develop.

Exhibit 7: Greek Government Revenues and Expenditures as a Percentage of GDP, 2002-2016



Source: European Commission, Eurostat.

Figure 2.1
Exhibit 7 : Greek Government Revenues and Expenditures as a Percentage of GDP, 2002-2016

As the figure shows, between 2006 and 2009, government spending in Greece rose from 45% to 54% of GDP, despite the strong growth of the Greek economy at an annual 4% pace in the earlier part of the period. The failure of government revenues as a percentage of GDP to improve was troubling. Normally, in a strong cyclical upswing with booming credit demand and strong wage growth, government revenues as a percentage of GDP increase because of the boost to incomes and profits and, therefore, tax revenues. That this was not happening should have served as a warning sign to investors of the possibility of widespread fraud and tax evasion. (Adam Kindreich, 2017).

Beside the GDP per capita which faced a downward in 2009, the other aspect that effecting the 'red' growth of Greece economy is the massive corruption practices within the government. In Greece, there is the term "fake man"

which means small envelope, it refers to the culture of giving small envelopes containing money to the state apparatus by the people related to administrative matters such as government business license expenditures. Corruption in Greece annually eliminates almost 30% of the country's revenues from total tax revenues, or about US \$ 20 billion. Surprisingly, the Greek government actually legalized the "fake man" culture in 2013 by arguing that giving a small thank-you note is not a violation of the law (Keep Talking Greece, 2016).

According to a study conducted by Daniel Kauffman, the level of corruption in Greece has cost Greece about 8% of its GDP (Wall Street Journal, 2017). According to a European Union survey of European Commission requests in the form of a journal entitled Special Eurobarometer 397, the EU claims that Greece is the most corrupt country in Europe, on par with China (EU, 2014) .

C. International Trade of Greece

Since the fall of communism, Greece has invested heavily in neighbouring Balkan countries. Between 1997 and 2009, 12.11% of foreign direct investment capital in the Republic of Macedonia was Greek, ranking fourth. In 2009 alone, Greeks invested €380 million in the country, with companies such as Hellenic Petroleum having made important strategic investments. Greece also invested €1.38 billion in Bulgaria between 2005 and 2007 and many important companies (including Bulgarian Postbank, United Bulgarian Bank Coca-Cola Bulgaria) are owned by Greek financial groups. In Serbia, 250 Greek companies are active with a total investment of over €2 billion. Romanian statistics from 2005 show that Greek investment in the country exceeded €3 billion. Greece has been the largest investor in Albania since the fall of communism with 25% of foreign investments in 2016

coming from Greece, in addition business relations between both are extremely strong and continuously rising.

Despite its great foreign investment, the cash inflows to Greece was lesser than the outflow cash. The crisis in Greece as explained earlier was also due to an imbalance between income and expenditure that led to Greece having no feasible funds that could be allocated to pay off its foreign debts. In this case, stronger evidence can be found in aspects of export & import. It is known that the value of Greek exports is much lower than the value of imports. It also indicates that the level of consumerism in Greece is quite high. The imbalance between the balance of exports and imports within Greece contributes greatly to the instability of the country's economy.

Greece is the country with the 63rd largest export value in the world and is a country with a complex economy ranked 54th according to data from the Economic Complexity Index (ECI). The main products of Greek exports are processed oil worth 10.5 billion US dollars, other products are medicines in packaging, aluminum, fish, processed vegetables, cargo & passenger vessels, and gas. Greece's largest export partners are major countries such as Germany, Turkey and Italy. While the largest import partner is Germany and Russia.

Accordingly, the total value of all Greek exports is \$ 33.2 billion USD.⁸ Although Greece ranks 63th as the country with the greatest export value in the world, but the value of Greek exports cannot keep up with its import value. The value of Greek imports also ranked 63 as the largest importing country in the world with an import value of 60.8 billion US dollars. This means that in terms of exports and imports Greece experienced a deficit of 27.6 billion US dollars.

D. The History of Greece and EU

Greece joined into European Union and obtain associate member status on 1962 and full membership in 1981. There were apparently three requirement that have to be fulfilled by a country in order to join European Union as;

1. Region Status: Countries that are allowed to join the membership of european Union are countries that located within the European continent
2. Politics Condition: a political condition within the country wishing to be a member of EU has to be in the stable state
3. Economy Conditon: A country that wanted to join the EU is required to have a good economy condition. Hence, it would not offend the condition of other members

On its first entrance in European Union membership, Greece fulfilled those requirements. However, after coup d'etat over the democratic regime in 1967, the only requirement passed was region status. After the long battle, Greece finally obtain the full membership status of European union in 1981. Unfortunately, that was not the end of the fought. After joining the membership of EU, Greece have to face difficulty in competing with industrial market within the North Europe which more developed and sustained. As the consequences, they experience a drop on its GNP per capita from 58% to 52% on 1991. Between 1980-1990s, Greece was greatly indebted to EU regarding its financial deficit. Hence, on February 7th,1992 a *Maastrict Treaty* (European Union Agreement) held in stating that Greece is the only legal member of European Union which could not fulfill the whole requirements.

Maastrict treaty basically regulates the adoption of Euro currency as the main currency within the continent

whereas the purpose of the regulation is to maintain the stability of goods prices within the Euro Zone even though there are countries which are not joined the organization.

These four requirements based on Act 121 (1) Maastricht Treaty are:

1. Inflation rate:

The inflation rate should not be 1.5 percent higher than the average rates of the three members with the lowest inflation rate in EU.

2. Financial of Government :

Annual Government Deficit:

The annual government deficit ratio with gross domestic product (GDP) should not exceed 3% by the end of the next fiscal year. Otherwise, the country is required to reach a level close to 3%. Only exemption and temporary exemptions are allowed to be excluded.

Government Debt:

Gross government debt ratio with GDP should not be more than 60% by the end of the next fiscal year. Even if this target is not achieved due to certain conditions, the ratio should be at least reduced and close to the reference value with satisfactory progress. By the end of 2010, only two EU member states, Poland and the Czech Republic, achieved this target,

Exchange Rate

The registrant must undergo an exchange rate mechanism (ERM II) under the European Monetary System (EMS) for two consecutive years and should not devalue its currency during that period.

3. Long-term interest rates

The nominal of long-term interest rate should not be more than 2 percent higher points than in the three member countries experiencing the lowest inflation. Inflation, budget deficits, debt, and high interest rates make Greece unable to join the EU community. However, Greece continues to work on improving its economy with various savings programs until this effort is paying off. Greece can finally meet the criteria: inflation 2.1%, budget deficit 1.7% of GDP, below 3% of the provisions of the Maastricht Treaty. Greece was declared eligible to join the Eurozone and adopt the Euro as its currency in 2002. The official Euro currency, was used as the Greek currency to replace the previous currency, namely Drachma. (Cohen, 2011)

E. Story of Greek Bankruptcy

In the beginning, the ambitious attempt to create a new multinational currency went well in Greece. The predicted problems with banks and vending machines never materialized. Moreover, with the euro surpassed the dollar in value, Greece have a high confidence level to its economy condition. The launch was hailed as a success, and the economy of Greece was one of the rapidest growing economies in Europe between the years 2001 and 2007. During those years, it maintained an annual growth rate of 4.2%, which was mainly possible because of the enormous amount of foreign capital that the country received, nad the budget deficit was reported to be only 1.5%. (GreeceBankruptcy, n.d.).

However, following the global economic recession which began in the year 2008, Greece economy condition substantially changed. Morover, some news revealed the fact that actually the deficit reported was not the real

condition, and the real condition was 5.5 times higher. (Melvin, 2015).

On October 4th, 2009, George Papandreou became the Greece's prime minister. Papandreou's Panhellenic Socialist Movement (PASOK) party wins power after New Democracy calls a snap general election, asking the Greek people for a new mandate to tackle the looming financial crisis. The Greek economy has contracted by 0.3%, and the national debt has risen to €262bn, from €168bn in 2004. At this stage, the government expects the 2009 deficit to reach 6% of GDP. Papandreou admits that the Greek economy is in "intensive care", as European finance ministers express concern about the size of the country's debt, and Papandreou unveils a radical reforms on its financial structure in order to cut the deficit by four percentage points, as a proportion of GDP in the following year of 2010-2011. Yet, at the same year following the reforms, the country's 2 chief industries, shipping and tourism fell dramatically, recording 15% lower revenues in the year 2009. (Wearden, 2010).

In the late 2009, international investors, spooked by the revelation that Greece's previously announced debt and deficit figures were inaccurate, became worried about the country's ability to pay its debts. Greece's credit rating was downgraded, first by Fitch and then by Moody's. The country's cost of borrowing spiked, and the situation risked running out of control. So the other eurozone countries, in the form of the so-called troika -- the European Commission, European Central Bank and International Monetary Fund -- stepped in to prop up the patient.

On early 2010, Greek population told to accept lower bonuses and higher taxes or risk bankruptcy. (Smith, 2010) In the following days, Papandreou asks Obama for help. He asked Obama to impose stricter regulations on hedge funds and currency traders, who they blame for

aggravating their problems and making it harder for Greece to borrow money.(Wearden, Greek PM to urge Barack Obama, 2010). In the same year finally Greece admits that it may need help from International Monetary Fund, and S&P downgrade Greek credit rating to junk status.