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## The Greek Sovereign Debt Crisis: Causes, Impacts and Some Policy Recommendation

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### Abstract

The Greek Sovereign Debt Crisis, exposed both Greece and Eurozone. Greek authorities had failed to overcome endemic problems of fiscal mismanagement, low competitiveness and trade deficits. Steady deterioration of Greek macroeconomic fundamentals and disappointing market expectations from Greek fiscal liabilities can be considered as the basic reasons of Greek crisis. Greek Debt Crisis has also brought questions with the Eurozone which has unified monetary policy and diverse fiscal policies. At this point, it has come to light that there may be a risk of contagion to the other EMU countries. This article provides an overview of the sovereign debt crisis in Greece, outlines the major causes of the crisis focusing on both domestic and international factors and the response of the local and Eurozone authorities to the crisis. Finally, short run and long run solution suggestions for the crisis will be explained.

**Keywords:** Greece sovereign debt crisis, Eurozone, Fiscal sustainability, Debt restructuring.

**JEL Codes:** F34, G01, G18, G34

### Introduction

Greece has been fighting with a classic sovereign debt crisis. However, this situation is not surprising if the recent economic history of Greece analyzed in detail. In 01.01.2001, Greece was accepted as a member of Eurozone on the ground that Greece had fulfilled the Masstricht Criteria. However, Greece owed this result to the false declaration of its macroeconomic conditions for 1997-2003 period. When the truth came out in 2004, it was soon understood that public sector deficit and, Gross National Debt to GDP ratio exceeded the Masstricht Criteria. The truth is that Greece entered the European Union with a great debt and continued to accumulate high levels of debt from highly liquid capital markets during the decade before the crisis. Heydays gone fast, and as soon as the crisis unfolded, the capital markets immediately became illiquid. Greek authorities have introduced a variety of austerity measures and expected the European countries, especially Germany and France, to provide financial assistance along with IMF. As the joint rescue package that was planned by the EU and IMF in May 2010 was not enough, another aid package was presented in July 2011, and additional amenities were provided. However, all these effort

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were not enough to dissuade international credit rating agency Standard and Poors from lowering the country's credit rating to the world's lowest level on June 13, 2011.

Today many authorities accept that the reasons behind the crisis of Greek economy were characterized by the great budget deficit, current account deficit, increasing public debt and a great amount of corruption that covered most of the public authorities. Beside these, wasteful expenditure of public sector and higher life standard expectancy of Greek people who were ready to get into debt at the expense of inability to pay are the other reasons of the sovereign debt crisis.

In addition, although this crisis struck Greece, because of the high interdependence and financial linkages, there may be a probability of transmission of it to the other member countries. What is more, the increasing level of default expectancy may result in fast and sudden capital outflows as the financial institutions are highly integrated with each other in the eurozone. Not only Spain, Italy, Portugal and Ireland, but also the core countries of the union are under the risk of contagion.

Lastly, Greece's debt crisis has brought a critical question about the merit of the euro, as the currency of the union. Some also emphasizes on the possible complexity of unified monetary policy and nationally diverse fiscal policies.

Because of all these problems mentioned above, the Greek and Euro area authorities should take certain and effective precautions to fend off the debt crisis. Furthermore, the longer the process, the higher the contagion risk. In the proceeding pages, background information about the Greek economy (before and during the crisis) and causes of crisis from different perspectives will be explained. At the end of the article, some functional precautions and macroeconomic policies will be suggested.

### **1. Greek Economy: Towards the Crisis**

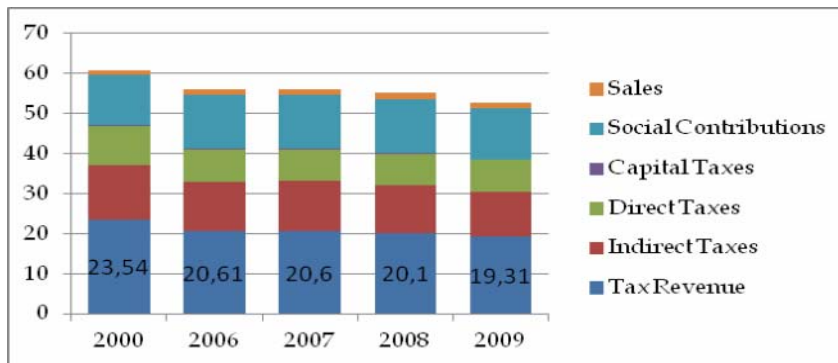
During the last four decades (1970–2010) the average annual growth rate of real per capita GDP in Greece was 2.96% which was not too bad. However, it is a fact that the Greek economy never became stable, and boom and bust periods followed each other in all these years. In 1994, the Greek government set a goal to enter the euro area on January 1, 2001. Despite the fact that there was a great amount of public debt and large budget deficit, the Greek economy entered a pre-EMU accession period. Until 1999, in order to be admitted to the euro area, Greek economy authorities tried to reach a reduction of 9% of GDP in its budget deficit. The government tried to reach a convergence of economic indicators to other European Union countries (Tavalas and Gibson, 2011:2).

However, the threat of exclusion of the pre-EMU accession phase forced the Greek authorities to execute budget constraints to fix the fiscal imbalances (Katsimi and Moutos, 2010: 569). During 1995–2001 period, the effects of recovery was felt. Real per capita GDP grew to the rate of 3.14% and labor factor grew by 0.75. At the end of the recovery phase, real per capita GDP was 77.16% with respect to its trend. Besides, real per capita consumption expenditure was 86.76% and real per capita investment expenditure was 67.99% relative to its trend (Gogos et. al., 2012:1-2). On January 1, 2001, with a low real growth rate and a very high ratio of public debt account to GDP (103%), Greece became the twelfth member of the euro area. As soon as Greece entered the euro area, positive effects started to be seen in the economy with sharply-reduced interest rates. The nominal interest rate on 10-

year Greek government bonds declined from about 20% in 1994, to less than 3.5% in early 2005. Besides, in 1995 spreads were 1.100 basis points. Spreads fell almost 100 basis points in 2000, in the eve of entrance to EU. With the entrance to EU in 2001, spreads fell to 50 basis points and continued to narrow subsequently. An other decline of 10 to 30 basis followed this term between 2002–2007(Nelson et al., 2010: 3).

In 2001–2007 period, real per capita grew with the rate of 3.75%. In the period of 2001–2008, real GDP rate increased by an average of 3.9% per year which was better than Eurozone average of 3.1% (IMF, 2009: 64). This increase was couraged by household spending for consumption (because of easier access to credit), housing investment and other business investment (Tavalas and Gibson, 2011: 4). Increasing private consumption and increasing public expenditure were financed by the EU and the central government induced the growth of GDP. On the government revenue side, from 1993 to 2000, the share of tax revenue in GDP increased by about 8% whereas the share of government spending remained the same. Until 2008, total government spendings were between 43–45% of GDP, whereas tax revenue showed a smooth declining trend 42.9% in 2000, and 39.6% in 2007 (Kouretas and Vlamis, 2010: 394). This decline can be explained by closing companies, decreasing production, increasing unemployment and most probably tax evasion. Below, in figure-1, public revenue to GDP percentage is illustrated over 1996–2009 period. Maybe because of lax tax laws and tax evasion, the direct tax revenue/GDP ratio was much less than the eurozone average in every period.

Figure-1: Public Revenue / GDP (%)



Source: (Eurostat, 2010)

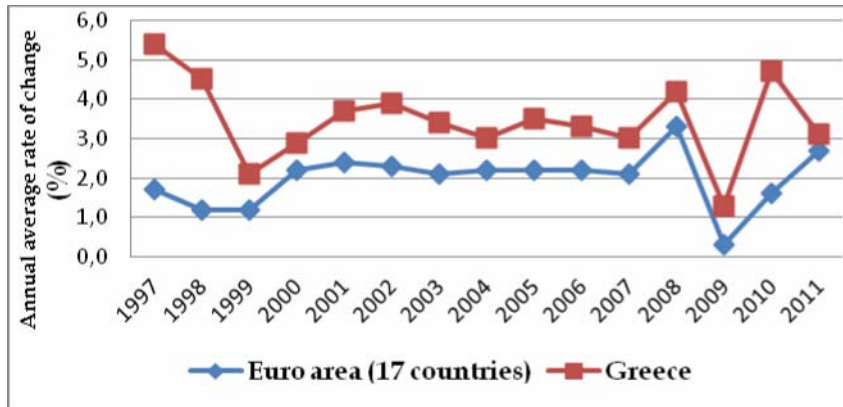
Until 2007, the central government’s expenditures increased by 87% while revenues grew only 31% (Greek Ministry of Finance, 2010). This gap resulted in large budget deficits which were much higher than 3% of GDP, the level EU set as threshold (Nelson et al., 2010: 3). From 2007 to 2010, the annual average growth rate was -5.05%. As expected, labor factor declined to -1.03%, and partially offset by a positive contribution of capital factor, 3.61% (Gogos et al., 2012: 10). Among these terms, especially the 2001–2007 period is important for the Greek economy since this period can be considered as the first years of the country as a member of the EU. Those are the years that Greece used the EU funds uneconomically and prepared the basis of the dramatic Greek debt crisis. Below, in table-1, a general macroeconomic performance of the Greek economy over 1980–2010 is given. According to table-2, current account balance worsened over the years.

**Table-1: Greece's Macroeconomic Performance (1980s-2000s)**

| Annual Average                       | 1980s | 1990s | 2000s |
|--------------------------------------|-------|-------|-------|
| Real GDP Growth (%)                  | 0.8   | 1.9   | 3.6   |
| Government Balance (% of GDP)        | -8.1  | -8.5  | -4.9  |
| Current Account Balance (% of GDP)   | -3.9  | -2.5  | -9.1  |
| Annual Inflation (%)                 | 19.5  | 11.0  | 3.4   |
| Exchange Rate (% Rate Change vs USD) | -281  | -93   | 35    |

**Source:** IMF (May 2010) Country Report, Greece: Staff Report on Request for Stand-by Arrangement.

As expressed with the data above in table-1, until 2001, Greece had to fight with the high inflation and debt interest rates which were always above 10%. In 2000s, it was almost 3.4%. Briefly, being a member of EU brought prolonged and robust growth, and relatively low inflation with respect to its historical standards. However, it should be emphasized that the inflation rate was still high by euro-standards, with the degree of 1% higher per year than the rest of the euro area (Tavalas and Gibson, 2011: 4).

**Figure-2: Greece and Euro Area Inflation 2001-2010 (Based on annual % changes in overall Harmonised Index of Consumer Prices)**

**Source:** (Eurostat , 2012)

Figure-2 gives more detail information about the change of inflation between 1997-2011. In figure-2, the sharp decline in 2009 could be observed which represents the strike of the Global Crisis. However, in the proceeding months, towards 2010, a steeper incline in the inflation rate could be seen for Greece. In 2011, it turned to downwards which represents the start of recession.

When the global crisis erupted in August 2007 and the collapse of US subprime mortgage market was released, there was a limited impact on Greek financial markets. Spreads on the 10-year instrument remained almost the same with its July 2007's values, as 30 basis points. However, the reaction of financial markets was not late. Greek bonds rates were downgraded by three major credit rating agencies. Before the crisis, Greek 10 year bonds were 10–40 basis points above German 10 year bonds. With the collapse of Lehman Brothers, spreads widened to 60 basis, and in March 2009, the Greek bond spread reached 285 basis points. After the election that was held in October 2009, a dramatic increase of the spread was recorded, probably because it was clear that public debt was not sustainable. Just after the crisis, in January 2010, the spread increased to an all-time high value of 400 basis (Reuters, 2010) which brought a loss of confidence of investors in the Greek economy. Although Greece could manage to sell 8 billion Euros in bonds at the end of January 2010, 5 billion Euros in bonds at the end of March 2010, budget deficit was far behind the decrease. So, at this date, Eurozone countries suggested providing financial assistance to Greece in concert with the IMF (Nelson et al., 2010: 3). It kept rising and reached 586 basis points in April 2010. In this period, absolute levels of nominal interest rate was 3.5% to 4.5% compared with a range of 5.0% to 6.5% in the year prior to euro-area entry. Nevertheless, after the Global Crisis, interest rates have shot upward, with the 10-year government bond yield increasing to almost 12% at the end of 2010 (Katmisi and Moutos, 2010: 569).

Towards the end of 2009, a double shock hit the economy. The first important one was a local political improvement. In October 2009, the new Prime Minister George Papandreou unveiled three separate packages of fiscal austerity measures to reduce the budget deficit for 2009, nearly doubling the previous estimate of 6.7% of GDP to 12.7% of GDP (Oxford Economics, 2010), and sequentially below 3% by 2010 (however, 12.7% was updated in the coming days and rose to 15.4% of GDP). Totaly, the measures were worth almost 16 billion Euros or 6.4% of GDP. On March 3rd, 2010, Prime Minister Papandreou prepared new austerity measures. A significant percentage of additional revenues for the government would be generated by crackdown on tax evasion and improved collection of social security contributions. On the expenditure side of the government, most of the spendings would be cut especially on the civil service. Also, civil servant employment froze in 2010 with 5:1 retirement/recruitment ratio for 2011, plus a 10% cut in civil service salary bonuses; a freeze on state pensions and 30% cut in public sector supplementary pay (Nelson et al., 2010: 7).

The second improvement came from abroad in November 2009 via Dubai World. The owner of the government of the Gulf emirate asked for a six-month moratorium. This event caused a great fluctation in the world finance market and led a sharp increase in risk avesion. Greece's government borrowed heavily from abroad to fund substantial government budget and current account deficits until the global financial crisis that erupted in fall 2008 (Tavalas and Gibson, 2011: 5).

From 2001, the year Greece adopted the euro as its currency to 2008 the budget deficits that the government announced averaged 5% per year which is 3% higher than the eurozone average. Also, reported current account deficits were averaged 9% per year, compared to a

eurozone average of 1% (IMF, 2009). In 2009, the budget deficit was more than 12% of GDP. Greece tried to fund these deficits by borrowing from international capital markets despite the chronically high external debt of 115% of GDP in 2009 (Economist Intelligence Unit, 2010) which was almost twice the standards of EU's Stability and Growth Pact<sup>1</sup>.

Reliance on external financing for funding budget and current account deficits by the successive Greek governments made the economy highly vulnerable. In spite of this vulnerability, Greece could manage to find new funds from international markets though most of the countries in Central and Eastern Europe suffered from a liquidity crisis in fall 2008.

The large bail-out package the IMF and EU governments did not allow the possibility of debt restructuring for Greece in case the extremely ambitious adjustment failed. Furthermore, by May 2010, the Greek crisis was spreading across Europe. As the confidence evaporated in Greece since its competitive position was still so weak, markets were no longer willing to provide the country's government with any new funds. European banks were holding large amounts of government debt and some of them were at risk in case of a disorderly default of Greece. Policymakers finally recognised the severity of the situation and in addition to 110 billion Euros bailout package offered by the EU/ECB/IMF, an additional 750 billion Euros package was set up on May 10th, 2010 in order to protect the eurozone from the crisis (Katmisi and Moutos, 2010: 573). This amount was added to the already decided €110 billion package for Greece, bringing the total amount of €860 billion, significantly above the amount the US committed under the Troubled Asset Relief Program in 2009.

Despite all those efforts, there was a great doubt and fear of investors that the sovereign debt crisis would transmit into a wider banking crisis because of the interconnections among the national banking system in Europe (BIS, 2010). To save Greece and to protect the rest of the Europe, European Commission set targets to correct budget deficits stretching 2012–2013. In spite of the efforts of both local the EU authorities, the performance was not adequate. In 2010, Greece's tax revenue increased to 32.2% of GDP against OECD average of 37.8% (Rossi and Aguilera, 2010:2). Until mid-January 2012, the Greek government could not convince the European Commission and financial markets. According to Greece's Stability and Growth Program, in January, 2012, by reduction of spending on public sector workers, defence and healthcare, it was targeted to cut the budget deficit 3% by the end of 2012. Besides, it was expected that increasing tax collection, applying reforms to decrease tax evasion and fiscal transparency would also help to reduce budget deficit (Darvas et al., 2011:2).

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<sup>1</sup> Stability and Growth Pact aims to keep members' fiscal deficits below 3.0% of GDP and their debt-to-GDP ratios below 60% of GDP. In the case of the debt-to-GDP ratio, countries can be accepted if the debt ratio approaches to 60% critical value at a satisfactory pace. The latter criteria was applied to Greece. In 2000, Greece welcomed to the euro area with a debt-to-GDP ratio near 100% of GDP (because the ratio was on a declining path) and a fiscal deficit initially reported at 3.0% of GDP; the latter figure was subsequently revised to 3.7% of GDP after Greece became a member of Europe's monetary union.

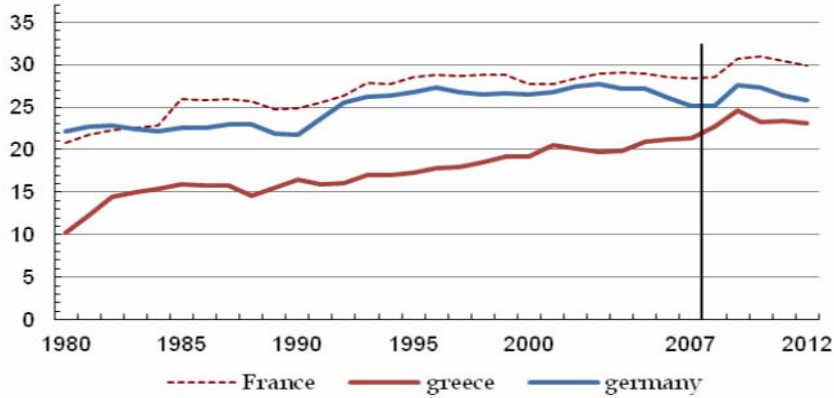
## 2. Possible Causes of Greek Crisis

Greece's current economic problems are a result of a combination of domestic and international factors. In the proceeding pages, causes of crisis will be explained according to endogenous and exogenous reasons.

### 2.1. Endogenous Causes of Greek Debt Crisis

Between 2001–2009 period, two basic problems were growing in the Greek economy: fiscal imbalances and the country's weak competitiveness. Although the economy was getting more fragile towards the end of the decade, the amount of foreign capital inflow increased. While capital inflow was 5% of GDP in 1995, it reached to 100% in 2008 (Dadush, et al., 2010:25–27). Over the nine-year period until 2008, Greek exports to import rate grew at 3.8% per year. This value was only half of the rate of imports of Greece from other trading partners. The increasing level of import, parallel to the domestic demand, triggered the current account deficit. While it was 3.7%, it reached to 14.4%. Also, Greece violated the limits of budget deficit 3% every year (Bank of Greece, 2009). Besides, expectation of IMF about the exchange rate actual in Greece was around 20–30% (Dadush, et al., 2010:26–27). Under this circumstance, it was obvious that Greece would lose its competitiveness. Increasing demand worsened the price and employment costs. Observers emphasized on overemployment and poor productivity in the public sector as one of the biggest problems of the economy. Besides, increasing prices and wages at relatively high rates affected competitiveness negatively (Oxford Economics, 2010). In this period, competitiveness, as measured by consumer prices, declined by around 20%; as measured by unit labour costs, it declined by almost 25%. Since 1997, increase in consumer prices increased to 47% which is much higher than the eurozone average, 27%. Similarly, unemployment compensation increased 80% since 2000. It improved to 23% of eurozone average in the same period. Between 2001–2008, wages grew at an average of 5% which was double the average rate in the euro area. Just in 2008–2009 nominal wage increases reached 12% (Dadush et al., 2010:28–30).

Besides overemployment, aging Greek population put additional burden on the public spending and the pension system which was considered as Europe's one of the most generous pension systems (IMF, 2010:6). During 2001–2008 period, the Greek government faced such high deficits as it indulged in high government expenditures especially in pension benefits and healthcare benefits (11.6% and 5.7% of GDP on average over 2001–2007) (OECD, 2012). In figure-3, social expenditures between 1980–2012 is illustrated. As shown in figure-3, three countries Greece, France and Germany were compared in social spendings. Although Germany had a better economical structure, it cut the expenditures in the crisis term, whereas Greece continued to increase the social expenditures despite its bad economical conditions and the coming crisis. After 2009, it started to decrease those expenditures. However, it should be noted that this decline was recorded because of the imposes of the other EU countries and the EU institutions.

**Figure-3: Comparison of Social Expenditures (1980-2012)**

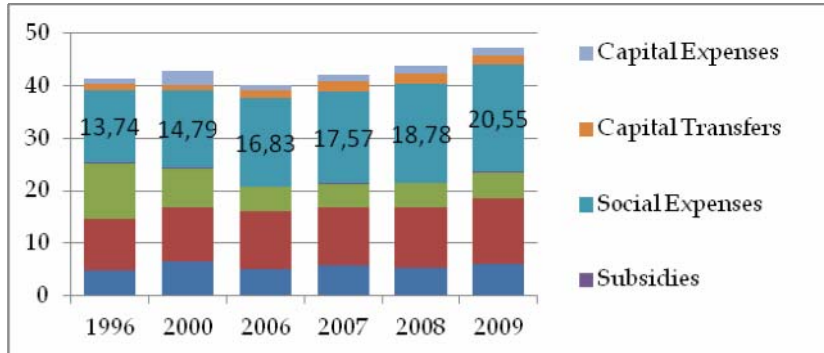
Source: (Eurostat, 2012)

Greece's government tried to reduce the budget deficit by excessive tax increases. However, as Perotti and others (1998:13) expressed, the fiscal adjustments that rely too much on increasing tax revenue, in stead of cutting public expenditure are likely to be less successful. Furthermore, tax evasion and an unrecorded economy obstructed the improvement of its fiscal position via direct tax revenue. According to a rough estimation, the ratio of the unrecorded economy represents 25-30% of GDP (IMF, 2010). Besides, complex tax codes, excessive regulations, long transactions and inefficiency in the public sector resulted in higher level of tax evasion (Nelson et al., 2010:4). Weak revenue collection unfortunately lead to higher debt borrowings which was 119% of GDP in 2009 and 144.9% in 2010 (Eurostat, 2012).

On the other hand, despite these austerity measures, the government generally refused to cut public expenditures. In particular the military expenditure of the country was dramatically high compared to the other EU member counterparts. According to the data revealed by Stockholm International Peace Research Institute, between 2005-2009, Greece was the fifth greatest weapon importer with 4.615 billion dollars expenditure (Dağdelen, 2011:10). Because of these wrong policies, government spendings rose from 45% of GDP in 2001 to 50% of GDP in 2009. Government debt-to-GDP ratio remained almost 100% through the 2001-2009 period (Kouretas and Vlamis, 2010:403). The debt-to-GDP ratio continued to increase in 2010 because of the 110 billion Euro rescue package. Greek government failed to decrease the budget deficit, and related to this insuperable problem, public debt became unsustainable in the long run. In figure-4, as a percentage of public expenditure to GDP for 1996-2009 period is given.



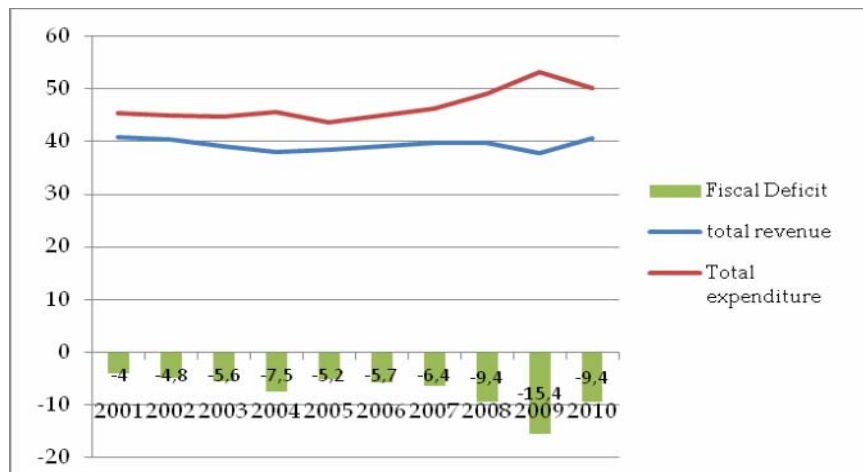
**Figure-4: Public Expenditure / GDP (%)**



Source: (Eurostat, 2010)

After the entrance to the EU, with relatively high real growth rates and declining competitiveness, the current account deficit, which had already topped 7% of GDP in 2001, rose to about 14.5% of GDP in both 2007 and 2008.

**Figure-5: The Fiscal Deficit, Total Expenditure and Total Revenue (% GDP)**



Source: (European Commission, Excessive Debt Procedure Notification, 2011)

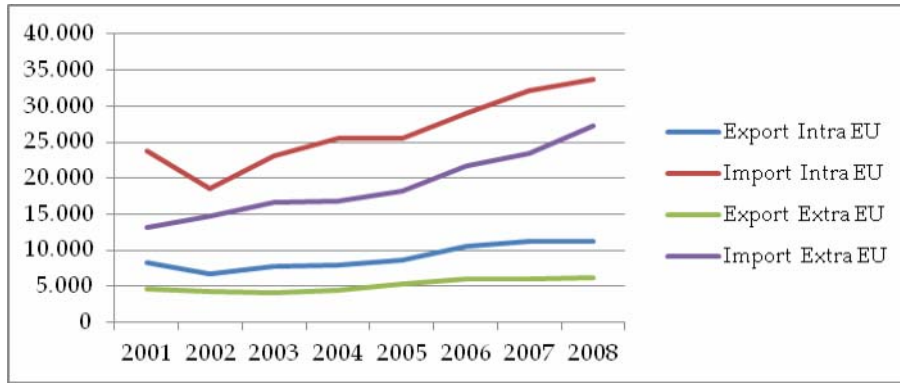
In figure-5, a data set for fiscal deficits, government expenditure and revenue were given as percentages of GDP between 2001–2010, the period Greece sovereign crisis started. As indicated in figure-5, in the given period, deficits were consistently increasing and exceeding the Stability and Growth Pack’s limit of 3.0% of GDP.

In this period, it is clear that total expenditures were always higher than total revenues. Increasing current account deficit affected the budget deficit. In 2009, the Greek budget deficit reached to 15.4% of GDP (Eurostat, 2009). Besides, increasing public expenditure and increase in borrowing towards the crisis years, resulted in high level of accumulated public debt. The amount of Central Government Debt was 298.5 billion Euros on 31.12.2009. Furthermore, the Greek policy makers preferred to release the government spending

excluding debt interest payments since interest payments were steadily declining as a result of nominal convergence to the euro-area countries. The decline in debt interest payments made the Greek authorities comfortable as they thought there would always be a guarantee of a bailout by the other members of eurozone.

In contrast, the other eurozone countries followed an opposite strategy of a decline in government expenditure while tax revenue remained almost constant. Despite all these policy changes in the rest of Europe, Greek policy makers stucked to their views since public expenditure cuts reflects the higher political cost with respect to raising tax revenue. As a conclusion, the great differences between the first released and the actual values of budget deficits abraded the credibility of Greece as being a reliable partner in the of European affairs (Katmisi and Moutos, 2010:569).

**Figure-6: Export and Import Values of Greece (2001–2008) (Million Euros)**

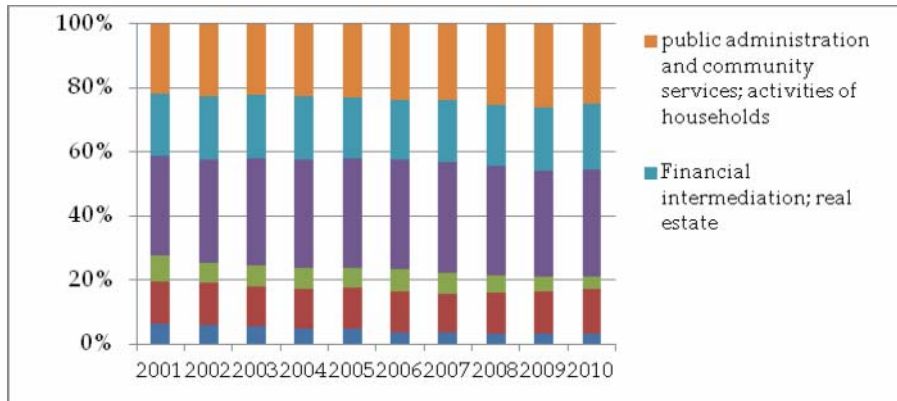


**Source:** (Bank of Greece, 2009); (IMF, 2009); (Eurostat, 2010)

Besides, as shown in figure-6, Greece gained trade deficits both with the EU trade partners and nonunion ones. Furthermore, the ratio of export to import decreased after the country entered the EU and monetary union. This increased the current account deficit which fed the budget deficit. Increase in both parameters resulted in twin deficit (Dağdelen, 2011:11). During the 2001–2009 period, competitiveness became even worse. Furthermore, instead of providing the role of an automatic stabilizer, the pro-cyclical stance of fiscal policy acted as a major source of shocks. In this period, the low levels of interest rate spreads caused little attentions of financial markets to the unsustainability of the fiscal and external imbalances. Decline in competitiveness deepened the severity of “twin deficit”.

Below, in figure-7, sector combinations for Greek economy for 2001–2010 period is illustrated. According to figure-7, tourism took a great part in the economy. The second most important sector was finance sector. Towards the end of the decade, the weight of the public administration increased in the economy. In the whole decade, agriculture, industry and construction sectors were always low.

**Figure-7: Sector Combination (2001-2010)**



Source: (Eurostat, 2012)

Rising twin deficit accompanied with the lack of structural reforms in labour market flexibility, social security and market competition urged the Greek authorities to issue new bonds at shorter maturity periods with higher interest rates compared to Germany. The financial authorities started to be suspicious about the ability of Greece to roll-over its debt because of high probability of sovereign default. As a result of these fluctuations in the Greek economy, the country’s credit declined steadily. Especially since 2009, credit evaluation agencies Moody’s, S&P, Fitch and R&I agreed to decrease the credit value of Greece. A sharp shrink was observed in one year.

## 2.2. Exogenous Causes of Greek Debt Crisis

With the entrance to the EU, Greece accepted the euro as its national currency. This policy change is considered as one of the reasons of debt accumulation of Greece. The heavyweights of the union, Germany, France, European Central Bank (ECB) and investors preferred to view the reliability of euro member countries with a heightened degree of confidence. That’s why, like the other Eurozone members, Greece could borrow at a more favorable interest rate and service existing debt. However, this policy contributed to accumulate its debt. In 2010, Greece lended 97.8 billion euros to the banks. This amount was 37% of GDP.

Besides, since 2003, more than 30 excessive deficit problem was faced, but the union never gave a punishment nor applied a sanction to the member countries that violated the rules. The lack of enforcement of the Pack couraged the countries like Greece to accumulate high level of debt. Furthermore, in February 2010, president Jean-Claude Trichet announced that ECB will continue to accept Greek government debt as collateral without caring about the ratings assigned by the rating agencies. Moreover, the ECB provided further support to buy euro zone bonds in the second markets. However, the ECB was explicitly not allowed to be a lender of last resort. The perception that economies or banking systems were too big or too complex to fail underlay the idea that their liabilities had implicit guarantees. Under these circumstances, market forces did not function properly: sovereign debt and credit risks were underestimated and mispriced, resulting in large cross-country divergences in fiscal and external current account balances (IMF, 2012:4-5).

**Table:2 Comparison of Government Debt Risk**

|                 | Budget Deficit 2010 (% GDP) | Debt-to-GDP 2010 | External Debt (% Debt) | Short-term Debt (% GDP) | Current Account 2010 (% GDP) |
|-----------------|-----------------------------|------------------|------------------------|-------------------------|------------------------------|
| <b>Greece</b>   | -12.2                       | 124.9            | 77.5                   | 20.8                    | -10.0                        |
| <b>Portugal</b> | -8.0                        | 84.6             | 73.8                   | 22.6                    | -9.9                         |
| <b>Ireland</b>  | -14.7                       | 82.6             | 57.2                   | 47.3                    | -1.7                         |
| <b>Italy</b>    | -5.3                        | 116.7            | 49.0                   | 5.7                     | -2.5                         |
| <b>Spain</b>    | 10.1                        | 66.3             | 37.0                   | 5.8                     | -6.0                         |
| <b>UK</b>       | -12.9                       | 80.3             | 22.1                   | 3.3                     | -2.0                         |
| <b>US</b>       | -12.5                       | 93.6             | 26.4                   | 8.3                     | -2.6                         |

**Source:** (EU Commission, 2011); (IMF, 2012).

Table-2 illustrates some of the critical countries, Greece, Italy, Ireland, Portugal and Spain, UK and USA government debt risks.

The table gives the chance to compare the macroeconomic situation of Greece with the other EU members, suffering from the crisis. According to the table, Greece has the highest external debt. Besides, Greece, Portugal and Ireland have high percentage of short term debt. In 2010, risky countries faced with financing constraints as well as poor track record of fiscal discipline. Greece found itself in the unique situation of suffering from twin deficits. Authorities claim that if the market had discouraged excessive borrowing by making debt financing more expensive, and the EU Commission had acted more strictly, Greece would have been urged to reform its economy and control the budget deficit with more rational ways. Oppositely, the EU gave a great chance to Greece to borrow more and more. However, when it came to crisis, most of the members were reluctant to give a hand to save Greece.

Another exogenous factor was the lack of solidarity funds at an EU level. As well known, EU is a monetary union but not an economic union with a Federal Budget. This means that while the monetary policy of Greece was in the Euro authorities' hands, economy policies were controlled by the local authorities. This two-headed system resulted in not only irregular management of Greece as country base, but also lack of adjustment mechanism to deal with such a crisis at a supranational level. Furthermore, having a common monetary policy deprived Greece from local monetary policy decisions. That was one of the most important reasons of trade deficit of the country. To improve competitiveness, governments prefer to devalue the local currency. By devaluation, export goods become cheaper than the competitors'. However, by union monetary policy, Greece didn't have such a power to compete with the other countries.

Finally, it should be noted that the other member countries did not show their good will to support Greece since it had failed to modernize its economy, refused to go to budget discipline and even falsified financial statistics. Actually, the attitude of the countries was not surprising since there was no clear or strong criteria in the Maastricht Treaty to help a member state if it is in a financial difficulty. On one hand, some of the eurozone countries were debating if bailouts were legal or illegal, on the other hand there was an obscurity for ECB's collateral eligibility criteria about accepting/refusing the downgraded Greek government bonds as collateral in liquidity provision. This complex situation caused hesitation for the financial institutions holding Greek government bonds.

**Table-3: Total Fiscal Assistance to Greece**

| Rescue Packages                               | Other Countries |              |              |
|---|-----------------|--------------|--------------|
|   | Germany         | France       |              |
| European Financial Stability Fund (EFSF)      | 440             | 147.4        | 110.7        |
| European Financial Stability Mechanism (EFSM) | 60              | 12           | 9.7          |
| IMF - Euro Rescue Plan                        | 250             | 14.9         | 12.3         |
| EU - Greece Rescue Plan                       | 80              | 22.3         | 16.8         |
| IMF - Greece Rescue Plan                      | 30              | 1.8          | 1.5          |
| Purchase of Government Bonds by ECB           | 60              | 16.4         | 12.3         |
| <b>Total- Billion Euros</b>                   | <b>920</b>      | <b>214.9</b> | <b>163.3</b> |

Source: (Sinn, 2010: 3)

In table-3, total financial assistance to Greece is shown. As illustrated in table-3, relief funds of Germany and France played major role in most of the rescue plans. In June 2012, the coalition government asked for an extra two years to meet Greece's fiscal targets. According to request, on top of the 173 billion Euros bailout plan agreed in the early months of 2012, Greece wanted an additional 16 billion Euros in financing from Europe. Europe was eager to help the coalition government to strengthen popular support for the country's bailout program and to combat Greece's deepening recession. Under Greece's current bailout plan, the country must achieve a budget surplus, excluding debt-service costs, of around 4.5% of gross domestic product from 2014 onward, compared with a deficit of 5% in 2011. IMF, EU Commission and European Central Bank (the troika) has demanded that Greece identify some 11.5 billion Euros of new public-spending cuts to cover expected budget shortfalls in 2013 and 2014 (The Wall Street Journal, 2012).

Lastly, the weakening regional trade is an other exogenous reason. Not only Greece, but also its major trade partners in Balkan Peninsula suffered from the global crisis. This resulted in a great loss in trade. However, it should be noted that recession hit Greece less badly than the other peninsula countries since it has a relatively small manufacturing sector.

### 3. Coping With the Crisis

Although there has been a dramatic situation not only in Greece, but also in the other risky countries, the EU policies have been insufficient to solve the crisis dilemma. There are certain reasons for it (Darvas et al., 2011:2):

- a. The EU authorities failed to recognise the possibility of insolvency and accepted the crisis as if it was just a liquidity crisis.
- b. The authorities also failed to analyze the interdependence between banking and sovereign crises and interdependence among the EU members and the other countries that have economical and financial relationships with them.
- c. They have been reactive rather than proactive to handle the crises.

However, since the debt crisis has been affecting not only Greece, but also the rest of the union because of close economical and financial links, Greece should receive serious support from the EU. In May 2010, the EU member countries and the EU Commission agreed to execute a protection package. According to this package, a European sustainability mechanism would be organized with 500 billion Euros budget. Those were, European Financial Stabilization Mechanism (EFSM) and European Financial Stabilization Facility (EFSF). EFSF would work like the credit conditions of IMF with the support of the EU and IMF. Under EFSF, by the support of all member countries, it would be possible to find funds up to 60 billion Euros from the fiscal markets. Additional to this amount IMF might give 250 billion Euros support. The EU authorities planned to execute ESM, European Stability Mechanism since mid-2013. ESM was planned to sustain stability of the euro zone. Particularly debt sustainability will be the main focus of ESM (Council of European Union, 2010).

After those programmes, governments of affected and nonaffected countries have implemented severe austerity measures and started to launch reform programmes. The ECB has embarked on a (controversial) peripheral sovereign debt purchase programme, while continuing its earlier support to euroarea banks with great liquidity provision but these measures have not been sufficient to restore calm in markets. In February 2011, spreads on 10-year government bonds issued by Greece, Ireland, Portugal and Spain were all higher than they were in April 2010, before rescue measures started to be implemented (Darvas et al., 2011:3).

Also, on 11.03.2011 the Euro Pack was signed among the eurozone countries. This pack targeted to improve competitiveness, to create close economical relationships between the member countries and to have higher coordination. The Euro Pack actually focused on the issues which were subject to national level. In this sense, it represented strong encumbrance of the local leaders. According to the pack, eurozone countries would take precautions to improve competitiveness, employment, sustainability of public finance and strengthen the fiscal sustainability. The local alternative actions would be chosen by the local governors (Euro Pack, 2011).

At the early terms of the crisis, most of the members of the union refused to help Greece as they insisted they had not enough capacity to do so. Oppositely, these countries have the financial capacity to bail-out Greece. In Greece case, a bail-out by the other euro zone governments would add about 3% to these governments' debt which is a relatively small number compared to the amounts added to save the banks during the financial crisis (De Grauwe, 2011:2-3).

Briefly, to restore market stability and regain credibility, swift, radical and comprehensive solutions should be launched immediately. Such a strategy must comprise of three components: fostering adjustment and growth by promoting budgetary consolidation and competitiveness-enhancing domestic reforms for Greece; revising the conditions of EU assistance and restructuring of public debt and banks wherever and whenever needed (Darvas et al., 2011:2).

### **3.1. Fiscal Coordination**

With the Greece crisis, it was understood that the Growth and Stability pact was insufficient to control the members and limit severe fiscal imbalances within the euro zone.

It was also clear that currency union without fiscal union is not enough to manage whole economic activities of the eurozone. Since the euro zone avoided the painful fiscal adjustments, protraction of austerity measures resulted in the substantial internal current account and competitiveness imbalances. Furthermore, the Global Financial Stability Report emphasized on the continuing high risks of financial stability inspite of the strict policies on euro area and banking crisis in April 2012. In the euro area, sovereigns and banks face significant refinancing requirements (23% of GDP in 2012). Deleveraging pressures are also likely to stay elevated. These pressures affect not only Greece but also strong economies (IMF, 2012:5-6).

Thus, because of all these risks, the euro zone has to strengthen the monetary union with the coordinated fiscal policies. Authorities emphasized also on the role of markets in the Greek crisis since markets provide money (Hallerberg, 2011:129-130). Some even claim that Greece would not have problems if 'speculators' were not trying to benefit from Greece's problems. Paul Krugman (2010) referred to such arguments as '*Bond Gods*' and suggested that the role of markets in fiscal matters is exaggerated. It is a fact that all countries that borrow to finance their deficits have to come to terms with markets. As Eichengreen (2009) argues, smaller noneurozone countries in particular faced market pressure during the fall of 2008 because of investor concerns about liquidity in these countries. Any solution to the current crisis has to anticipate the reaction of markets and their role in the future. Moreover, there are good reasons to believe that market discipline should be more effective in restraining states within Europe's monetary union than outside of it. First, exchange rate risk is not a cause of fluctuations in government bond prices as it is for countries with flexible exchange rates. Second, any eurozone country can receive emergency liquidity from the European Central Bank (Halleberg, 2011:129). All in all, market discipline is crucial for Greece in fiscal coordination. To have a well organized and good-working market discipline, the market should have accurate information on the status of current fiscal policy and on future developments (Halleberg, 2011:131).

To have market discipline, and to execute a new and credible fiscal charter, Greece had to include debt restructuring mechanism. For this issue, Greece decreased pension benefits, public sector spendings and salaries, increased taxes, and also tried to control tax evasion to follow rescue package. With those precautions, the interest rates on relatively short term government debt have fallen. However, longer term rates in the secondary markets for several euro zone countries still reveal perceptions of a substantial risk. There is also great risk in the bond markets with respect to the ability of Greece. So, further fiscal cuts may be needed over the next several years to reach expected conditions. Also, to keep fiscal adjustments from undermining domestic growth, the economy must be stimulated from the supply side since Greece cannot be expected to stimulate its economy by increasing consumer spending. The authorities and staff agreed that fiscal adjustment should be frontloaded and aimed at reducing the debt-GDP ratio from 2013 and the general government deficit to well below 3% of GDP by 2014. This would bring the primary balance to its medium-term target of 5-6% of GDP, essential to secure a rapidly declining debt ratio (IMF, 2010:12).

Finally, to reach these goals, public sector must be consistent. An adjustment programme that is supposed to re-establish debt sustainability cannot be credible if its main promoters such as politicians, the creditor member states etc... express their own scepticism about the

success of the programme by requiring punitive interest rates and making their claims senior. If Greece were to have to restructure its debt once the new mechanism came into force, the official creditors would be repaid first and the losses would mainly have to be borne by the private creditors. If the EFSF does not pretend to have more rights than a normal private investor, it will also become easier for the countries to raise funds on the capital market to pre-pay the EFSF should their economic conditions improve more than expected (Gros and Mayer, 2011:7-9).

However it was clear that the funding was not enough for Greece's bailout program since the deficit was too large for Greece to close on its own. For this reason, the EU authorities and IMF should negotiate to share the Greece's debt-service burden. This remedy may avoid a Greek bankruptcy that could force the country out of the euro and trigger financial panic across the eurozone currency bloc. Some euro-zone officials would like the ECB to extend the duration of Greek government bonds that it holds, or to promise to buy new bonds when existing ones mature, reducing Greece's need for money. But many ECB officials strongly oppose such concessions, equating them with illegal central-bank financing of government debt. This process shows that ECB will show less flexibility towards Greece. Greece, now, owes the IMF about 9.5 billion Euros in 2014 and 10.8 billion Euros in 2015 in interest and loan repayments. One option being considered in Europe is to expect from the IMF to delay the repayments, easing Greece's cash needs in the next few years. The Greek government could cover part of the gap by selling more treasury bills to private investors such as Greek banks, since it still has access to the short-term debt market. The March bailout was meant to put Greece on track to cut its government debt from at least 160% of gross domestic product in 2012 to 120% by 2020—a level Europe and the IMF see as "sustainable." (The Wall Street Journal, 2012). In any case, it should be clarified that the unions, institutions or the countries will help their own citizens, investors, and markets by helping Greece.

### 3.2. Sovereign Debt Restructuring

The sovereign debt crisis of Greece should be of direct interest to the other eurozone members. Since there is a common currency issued by a common central bank within the union, the crisis process needs closer relationships, coordination and cooperation among the members on fiscal policy and discipline. Furthermore, as European banks are the greatest holders of Greek bonds, the stability of those institutions is crucial for Greece's multilateral and bilateral supporters. So, an imbalance may threaten the stability of the banking sectors in the creditor countries. It should also be kept in mind that more than 30% of the bonds are probably owned by Greek institutional holders. A restructuring that decreases the value of those bonds may place further strains on the Greek domestic financial sector. Also, Greece's debt is denominated in euros which is the currency of the other members of the EU. In the debt restructuring program, there may be fear of losing confidence in euro (Buchheit and Gulati, 2010:4-6). Another problem is related to structure of the euro which is considered as both *foreign* and *domestic* currency. In the past, debt crisis of most of the emerging countries was because of external and denominated in foreign currency. Oppositely, public debt of Greece, and the other risky countries, is denominated in euro, and is mostly held by euro-area residents. Despite the local currency was euro in every country, it is different from the domestic debt of countries owning their own currencies since the issuing country does not have full control over the currency. Therefore, financial integration within the euro area created a new situation where debt is both foreign and domestic. Since the debt ratio of



Greece was exceeding 100%, and its holdings are concentrated mostly among residents of few euro partner countries, having a default may be more disturbing than expected. A possible default may threaten the solvency of the partner countries' financial institutions. In other words, a poorly managed sovereign default of Greece could result in a euro-area banking crisis. So, an important benefit of sovereign debt resolution mechanism is modifying the behaviour of banks and the financial sector in general, towards the holding of sovereign debt of dubious quality. This may limit the risk of bank failure and bail-outs (Gianviti et al., 2010:20-23). Also, debt restructuring provides with avoiding the complexities and intercreditor rivalries that can be occasioned by a diverse creditor universe. Besides, having power of financial support from multilateral and bilateral sources can bring a possibility of being able to credit enhance any new Greek debt instruments that can be considered as a part of debt restructuring (Buchheit and Gulati, 2010:4-6).

Since a mismanaged sovereign debt crisis can be catastrophic for both creditor and debtor countries, the transaction structure is crucial in this process. The structure for such a transaction would be offering new bonds. The new bond determines the nature and extent of the debt relief. In the eligible debt process, all Greek bonds can be included except short term Treasury bills in order to keep that market sweet for the government's financing needs. Also, the total amount of bonds in the retail hands would have to be relatively small. Besides, there must be certain mechanisms that will permit the government to identify which bonds are in retail hands when the restructuring is announced. Otherwise, bonds will tend to migrate temporarily into the hands of individuals until the restructuring storm passes over. Finally, as part of the restructuring process, Greece would have to consult with significant holders. These consultations would be necessary to get support for the restructuring process (Buchheit and Gulati, 2010:7-9).

Greece and the other countries that are under severe financial pressure should be under the EMU safety umbrella. Also, there should be a coordination between EFSF and ECB. Besides, the EFSF should be more eager to exchange the outstanding debt of the countries against its own obligations at the market price before the countries came under the umbrella. The EFSF should also buy from the ECB debt securities purchased within the framework of the Sovereign Market Programme. Once the debt exchange has been completed, the EFSF would negotiate with the debtor a reduction in the nominal value of the debt against an additional adjustment effort. The reduction in debt could be equal to the discount paid by the EFSF. Success of debt reduction is based on market prices that prevailed prior to the announcement of the debt management exercise. Then EFSF may sell the holdings to the sovereign and provide credit to finance buybacks. Finally, the EFSF could be the main lender of Greece and not private creditors. According to market estimates, Greek banks have posted approximately €70 billion of Greek government papers at the ECB as collateral for liquidity. An immediate recall of ECB liquidity would likely render most Greek banks bankrupt given absent alternative options for access to liquidity. To eliminate this risk, bringing foreign ownership to Greek banks could be a solution to liquidity problem. An other alternative would be a debt exchange of Greek government bonds: either a new bond of the Greek state supported by appropriate collateral, or a Brady-type bond guaranteed by the EFSF (Gros and Mayer, 2011: 5-6). The EFSF could also buy a certain amount of these bonds and sell them on to Greece. So, it could provide Greece with credit to finance the buyback. However, restructuring will not be easy both because of its impact on financial institutions that have

not marked debt securities to market and because of the seniority issue. In the restructuring process, the burden of adjustment should not be only on private bondholders. First, investors should be offered a variety of new, guaranteed instruments. Second, Greece should post collateral to guarantee the new debt instruments.

Greece and Ireland currently benefit from loans from EU states or the EFSM/EFSF at relatively high interest rates compared to the rates at which these countries or institutions are able to borrow. However, high interest rates have caused political tensions in the borrowing countries. High rates have also weakened the credibility of these programmes. On the other hand, it is a fact that debt buybacks in the secondary market may be insufficient to restore fiscal sustainability for euro area governments. Also, as the country would still have a substantial current account deficit, this amount of debt reduction would be insufficient to restore investors' confidence in the sustainability of Greece's public finances. Investors would also continue to demand elevated risk premia for Greek government bonds in the primary market, and the associated borrowing rates would lead to a snowballing of Greece's debt servicing costs in the years ahead (Kopf, 2011:17).

Finally, to avoid market turmoil, a debt-restructuring mechanism must guide market expectations effectively about the steps that will be taken in the resolution of a debt crisis and their likely outcomes. At the same time, it must provide policymakers with a game plan to resolve the credibility problem of the unconditional no-bail-out clause for EMU countries. Furthermore, the mechanism must set clear rules for involving the creditors in the crisis resolution, which would give creditors stronger incentives to care about the credit worthiness of sovereign debtors and thereby strengthen market discipline (Gianviti et al., 2010:7).

### **3.3. A Plan to Restore Banking Sector Soundness**

It is clear that there is a financial interdependence in the euro zone. Related to this interdependence, there might be a link between sovereign default and a bank crisis. There is also exposure of peripheral banks to potentially non-performing loans and the resulting risk for banks in the rest of the euro area, and for sovereigns in both peripheral and non-peripheral countries. Some authors claimed that Greece was bailed out because the French and the German governments wanted to make sure that their banks would not be destabilised by a collapse in the value of Greek government bonds. Before the Greek crisis, German and French banks used to buy Greek bonds and exposed themselves to Greek debt massively since they assumed that Greek debt was risk-free with the EU guarantee. This assumption was justified under pre-monetary union circumstances, when governments could print money to pay off their debts, but this approach is no longer valid. Once banks have become familiar with the new regime and adjusted to it, they had to limit their exposure to debt issued by countries that are at risk of default. So, the holders of the debt of such countries would demand an interest premium for the lack of liquidity of such bonds, thus rewarding governments that keep the risk of default low. This point implies that the creation of a debt-resolution mechanism in the euro area is important for financial market regulation (Gianviti, et al. 2010:32). After the public debt reduction in Greece, to get rid of the debt crisis, the collapse of the banking system should be avoided. To do so, recapitalisation and continued access to liquidity will also be needed. So, banks need to be recapitalised with public funds. Also, euro-area countries should create their own debt resolution institutions since lack of those institutions imposes even greater burden-sharing

on countries (Darvas, 2011:12). The ECB's recent suspension of the application of the minimum credit rating threshold in the collateral eligibility requirements on debt instruments issued by the Greek government will also serve as a useful liquidity backstop (IMF, 2010: 10).

### **3.4. Designing a European Monetary Fund**

A political unification does not seem to be possible, but founding European Monetary Fund (EMF), an idea created by Gros and Mayer (2010), could be an alternative solution to provide with the fund for problematic countries. According to Gros and Mayer (2010), EMF can be a complement to orderly defaults of private financial institutions and rescue funds for large banks. Without a control mechanism like IMF, debtor countries may confront with painful adjustment programmes which may be a threat of a disorderly default, creating systemic financial instability at the EU. In this frame, the purpose of this fund is not preventing failure of large institutions but to restore market discipline by making failure possible.

Sharing the same currency brought the members strong negative spillover effects. This situation brings a particular responsibility for euro members to avoid creating difficulties for their partners. This political expectancy underlying the Maastricht criteria for fiscal policy and the Stability Pact. The sovereign debt crisis of Greece showed that the member countries have right to expect support when faced with extraordinary financial difficulties. The crisis also showed that those countries should contribute to building up the resources. Related to this, the EMF which might be the authority of organizing an orderly default as a measure of last resort could obtain its funds from countries with excessive budget deficits and debt levels. The key advantage of the EMF would be managing an orderly default of an EMU country that fails to handle the conditions attached to an adjustment programme. Also, in the crisis terms it may not only give financial assistance to the countries but also act as an authority to impose conditions for the granting of financial assistance.

The contribution of the members can be based on the deficit and the debt level. Those two represent warning signs of impending insolvency or liquidity risk. The strong countries would not need to contribute so much as the peripheral ones because they would not need financial assistance so much as the others. EMF could provide financial support either by selling part of its holdings to provide the member country with a loan or it could just provide a guarantee for a specific issuance of public debt.

The funding of EMF could give clear incentives for countries to keep their fiscal balance in order and it could provide with an orderly sovereign bankruptcy procedure that minimizes the disruption results. Indeed, without a fiscal agent like the EMF in crises times, the ECB becomes the fiscal agent of the euro area governments by default. Correspondingly, incentives for fiscal discipline and the establishment of bankruptcy for euro sovereigns would lower the moral hazards. Finally, the EMF could contribute to the transparency of public finances since its intervention mechanism would penalise in the case of failure (Gros and Mayer, 2011: 5-6).

### **3.5. Fostering Growth and Competitiveness**

The countries that have problems in their competitiveness, generally face with deterioration in their budgetary position. For Greece, being a debtor and having deterioration in its

budgetary, regaining sustainability means a combination of lower living standards and higher production, especially in the tradable sector. In the country, inflation has consistently exceeded the Eurozone average, contributing to an estimated overvaluation of real effective exchange rate of 20–30%. Competitiveness was further eroded by rigidities in the domestic economy. Competition in internal markets is impaired, particularly in network industries (with large public sector participation). Weakly contested domestic markets result in high costs and poor underlying productivity. Furthermore, poor governance and regulation depress the potential for inward FDI, which is correspondingly low, while state enterprises are notoriously inefficient (IMF, 2010:6).

Right after the implementation of immediate rescue policies, economic policy should be geared towards implementing domestic reforms to increase employment and productivity. According to the Stand-by program, Greece signed with IMF in 2010, nominal wage and benefits would be cut. The country also targeted to improve price competitiveness, which would help Greece to have more investment and export-led growth model. (IMF, 2010: 10). However, because of the monetary union, essentially under the same nominal interest rates, competitiveness becomes even harder for Greece since it does not have the authority to devalue its currency in order to compete with the other countries. As a result, the insufficient proportion of export deepens the trade deficit (Milios and Sotiropoulos, 2010:238–239).

It is a fact that recovery process will be painful. In this procedure, growth will remain subdued. The debt reduction performance of private and public sector will have a negative impact on growth, and low growth will affect the debt reduction efforts oppositely. Besides, Greece has a increasing unemployment problem with low productivity. So, it needs to reduce its debt level while accelerating the pace of economic reform. Greece is also confronted with the risk of debt deflation, because restoring competitiveness in the tradable sector will require low price increases and perhaps even deflation. Furthermore, the establishment of the euro itself contributed to the perpetuation of asymmetries in the current account balances and divergences in the unit costs of labour and inflation. In order to break this circle, the EU should help with this by fostering reforms. The EU should also do more with the instruments such as temporary refocusing of the structural funds at its disposal (Darvas et al., 2011:9-11).

### **3.6. Greece and Exit Strategy from the Monetary Union**

Despite tourism and manufacturing sectors, Greece is a relatively closed economy with the lowest amount of production in the euro area. An exit from the euro zone would be disaster for the country since all financial assets would leave the country. The price-wage competitiveness is an other problematic of the country. As the current liabilities of corporations and households are denominated in euros, they would become increasingly expensive to pay off in the depreciating new Greek drachma that were likely losing value against the euro. A sharp depreciation of the exchange rate could push the private sector into bankruptcy as the private sector would face much higher interest rates (in real terms as well) with negative implications for growth and welfare. A forced exchange from euro denominated debt to new Greek drachma would have similar effect. Widespread bankruptcies of domestic firms and households would stress Greek banks much more than the restructuring of the sovereign debt. Such a situation would constrain any bank lending for many years (Darvas, 2011:27). Besides, as time goes by, the exit will become costly by the need for the ECB to consider the implications of tighter monetary policy on debt dynamics.

Higher interest rates make it more difficult to reduce debt-to-GDP ratios since debt-servicing costs rise, real GDP growth slows and primary budget deficits increase.

It deserves to be noted that while Greece is still dealing with its debt problem, it will be difficult for ECB to increase interest rates as higher interest rates in the eurozone may reduce investors' appetite for Greek debt. All of these would be drags on economic growth. Besides, monetary depreciation and the other risks may result in sudden capital outflows and budget squeeze for the country (The Economist, 2010:1). Because of these reasons, it is very costly and complicated to exit ECB.

### **Conclusion: Greece Needs Forgiveness**

Since wrong policies combined with opportunist actions of successive government authorities, the problem was postponed over the years in Greece. For at least a decade, politicians acted like bankers and produced unsustainable debt rates, as if sky was the limit. If the situation is evaluated in the light of moral hazard, politicians and the authorities cannot decline the responsibility. Besides, until the Global Crisis erupted, most of the investors had enjoyed investing on the Greek bonds since they thought the union would guarantee them. They ignored the worsening macroeconomic conditions of the country. So, not only the Greek authorities, but also creditor countries and great investors of the union should share the responsibility of the Greek crisis. It is a fact that the current fiscal problems of Greece does not just affect Greece but also the other EU members. Because of interconnection among the members, crisis can be transmitted to the other countries. It is clear that to get rid of the crisis, Greece needs more help and this is related to the other members of the EU and international institutions like ECB and IMF.

Also, a stand-alone currency made Greece need more help for its higher debt level than before. It is clear that sanctions only cannot stop the future crises. Furthermore, if the area of punishment enlarges and private market participants included, such as sovereign bond holders, these punishments may trigger crises by capital outflows, instead of preventing them. When those are applied to the design of financial assistance, these may cause lack of debt accumulation, and inviting the crisis. Also, the solution will most likely involve a combination of fiscal pain and debt restructuring. The Greek crisis showed the need for a current tightening of monetary policy, change the form of expansionary monetary policy of the ECB and additional fiscal policies. Before the Greek crisis erupted, tightening monetary policies by raising the repo rate, the main monetary policy instrument of ECB, was enough to control crisis since economical confidence was the key factor of ECB's interest rate decision. The less the confidence of the economy, the higher the interest rate it needs to pay. However, the Greek case showed those constraints were not enough to control the crisis.

To make a progress, the other parties of the problem (the other EU members) should have a willingness to forgive since the problem is not only Greece's but also creditors'. There is a nasty equilibrium that the higher the debts/credits with higher punitive interest rates, the harder for Greece to get rid of the crisis. And also, if Greece is allowed to go bankrupt, this will trigger a significant fiscal crisis in the whole eurozone (because of the intra-European character of the debt) and probably the crisis could spread to other countries with comparable fiscal problems. The mechanism will succeed only in so far as it is functioning within a framework of structural changes favouring capital. To handle the problem, the EU has already planned to initiate certain programmes. As an example, with creation of EFSF,

the union intend to help the countries those suffer from budgetary deficits or government debt. Further steps to create a viable fiscal supports are needed.

Besides, to strengten the competitiveness, there must be certain precautions to decrease unit labor cost which is higher than rise in productivity. Besides, to decrease trade deficit, not just tourism and construction, but also the other sectors should be supported so that export level can offset the import level. Additionally, government spendings should be cut and the society should support the austerity program as the credibility of the program is very important to be succesful.

Finally, it is not a right choice to leave the monetary union for Greece. It is a fact that leaving the monetary union may be more costly than expected since the amount of public debt will be increased. Also, because of interconnection within the union, banking sectors are very much integrated to each other. All the system must be reorganized after such a decision.

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## YUNANİSTAN BORÇ KRİZİ: NEDENLERİ, ETKİLERİ VE ALTERNATİF ÇÖZÜM ÖNERİLERİ

Ayfer GEDİKLİ\*

### Özet

Yunanistan borç krizi, sadece Yunanistan'ı değil, Avrupa Birliği içerisindeki diğer ülkeleri de olumsuz etkilemiştir. Gittikçe bozulan makroekonomik yapı, artan ticari açık, zayıflayan rekabet gücü ve hatalı finansal yönetimle Yunanistan, ekonomi yönetiminde yeterince başarılı olamadığını ortaya koymuştur. Öte yandan, bir yandan AB üyesi diğer ülkelerin, diğer yandan da yerel yöneticilerin tüm çabalarına rağmen kamu borçlarını ödeme konusunda piyasa beklentilerinin giderek zayıflaması, Yunanistan borç krizinin derinleşmesine neden olmuştur. Bu kriz, Yunanistan ekonomisindeki derin problemleri gün yüzüne çıkarması yanında, Avrupa Birliği bünyesinde uygulanan ortak para politikası ve ayrık maliye politikalarının da sorgulanmasına yol açmıştır. Üstelik birlik içindeki finansal bağımlılığın yüksek olması nedeniyle, para birliği içinde olan diğer ülkelere de krizin bulaşma ihtimali söz konusu olmuştur. Bu bilgiler ışığında, bu çalışmada Yunanistan borç krizinin endojen ve egzogen nedenleri belirtildikten sonra, krize yönelik olarak Yunanistan ve Avrupa Birliği tarafından alınan tedbirler üzerinde durulacaktır. Çalışmanın son kısmında ise krize yönelik olarak kısa ve uzun vadede uygulanabilecek alternatif çözüm önerileri açıklanmaya çalışılacaktır.

**Anahtar Kelimeler:** Yunanistan borç krizi, Avrupa Birliği, finansal sürdürülebilirlik, borç yapılanması

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