On the Greek national debt

The Greek economy has been struggling in deep recession and facing major problems with its national debt. Dimitrios Syrrakos examines some of the factors that led to the crisis

Key concepts

debt crisis, balance of payments current account, fiscal discipline, bail-outs

The financial crisis of the late 2000s triggered a global recession. Some countries were better-placed to deal with this situation – in particular, countries in the Eurozone faced constraints because of their inability to pursue an independent monetary policy, which disadvantaged some countries more than others. Greece was among the group of countries that suffered from this, and found itself with an unsustainable national debt.

The Maastricht Treaty

The Maastricht Treaty, signed in 1992, established the European Union (EU), and laid the foundations for the creation of the Eurozone, in which countries adopted the euro as their currency. Under the treaty, countries wanting to adopt the single currency were expected to meet certain convergence criteria, covering inflation, interest and exchange rates and in fiscal policy.

One such criterion was that countries should have a budget deficit no larger than 3% of GDP, and a national debt of no more than 60%. In 1993, there were three countries in the EU experiencing an exceptionally high debt-to-GDP ratio. Italy with a 130 percent ratio, Belgium with 118 percent and Greece with 112 percent.

EMU

However, all three countries were allowed to move towards the single currency by joining the European Monetary Union (EMU). Italy and Belgium were in the first wave on January 1, 1999 and Greece followed on January 1, 2001, by taking advantage of a flexible interpretation of the 60 percent debt-to-GDP threshold. According to this interpretation, countries were allowed to join EMU as long as their debt-to-GDP ratios were reduced at a ‘satisfactory’ pace. The term satisfactory was not closely defined, so as all three countries managed to reduce their debt-to-GDP ratios in the second half of the 1990s they were allowed to join EMU.
The launch of the euro
By the time the single currency was launched in 2002, the dynamics of their debt servicing had permanently changed. In the Eurozone, member countries relinquished control of monetary policy to the European Central Bank (ECB), which meant that their respective central banks could no longer engage in expansionary monetary policy when in a recession in order to devalue and regain their competitiveness. However, it is significant that Eurozone countries maintained fiscal independence.

Fiscal laxity
Fiscal laxity from the Greek Socialist government soon after joining the Euro from 2001 to 2004, and expansionary fiscal policy by the two consecutive Conservative governments from 2004 to 2009 rendered the debt crisis inevitable. The very slim majority commanded in the Greek Parliament by the second conservative government following the 2007 elections, meant that necessary fiscal cuts could not be legislated. The ensuing political instability and uncertainty over the true nature of the country’s public finances left no room for political manoeuvring leading to a snap election in September 2009. A particular issue was an enormous deficit on the current account of the balance of payments. Given that the country was a member of a currency union, this meant that the brunt had to be borne solely by fiscal cuts. The new Socialist government in office, elected on a promise to increase government spending, were slow to appreciate the gravity of the situation. By the end of 2009 capital markets fully recognised the Greek government’s impasse, both political and economic, and by early 2010 markets were requiring higher interest rates to purchase or recycle the country’s debt. By May 2010, Greece no longer had access to capital markets and it officially applied to the EU for a bailout.

The balance of payments
Figure 1, shows the evolution of the current account of the balance of payments for Greece, Germany and Italy from 1999 to 2011. As you can see, Germany experienced increased current account surpluses from 2001 to 2008. Italy saw a deterioration in its current account throughout the period, but only marginally exceeded the 3 percent deficit criterion imposed by the EU in 2010 and 2011. On the other hand, the Greek current account remained below minus 5 percent from 1999 to 2004, and deteriorated further from 2005 to 2008 reaching minus 14.78 percent that year, then improving to minus 9.2 percent by 2011. With the
Stability and Growth Pact imposing a 3 percent deficit ceiling to all EU countries, but primarily to Eurozone countries, Greece had still a long way to go in reducing its current account deficit.

From the analysis so far it would appear that Greece alone was to blame for its economic and social hardships that it has experienced ever since. Indeed, the scale of fiscal expansion pursued, in particular from 2004 to 2009, was inconsistent with membership of a currency union, let alone EMU.

Figure 1: Deficit on the current account of the Balance of Payments: Greece, Germany and Italy

\[ \text{Greek, German and Italian Current Accounts} \]
\[ \text{1999 - 2011} \]

Source: Word Development Indicators

**Other factors**
The state of the Greek economy did not only reflect fiscal laxity. Other factors include the fact that Greece consistently shows military expenditure that is higher than the EU average, at times second only to the UK or France. Greece also has a very ‘peculiar’ geography, including nearly 2000 islands, of which 200 are inhabited. Greece also lacks an industrial base and displays a clientele relationship between the state and citizens. Tax avoidance is common. This set of obstacles suggests that even if the current account is restored to
balance, this does not ensure that the country is going to avoid deficits in the balance of payments. However, since the creation of the Euro, there are also processes under way that involve all Eurozone member countries.

**The influence of the EU**

Indeed, prior to the Eurozone’s debt crisis, EU institutions’ policy decision making was informed more by aggregate data than by reference to individual countries. As a result, given that the Eurozone’s balance of payments position with the rest of the world was in equilibrium or marginally positive, there was no perceived need for remedial action to be taken. It was as if national accounting did not exist for individual countries in the Eurozone!

On at least three different occasions between 2004 and 2009, the then EU Commission President (and former Portuguese Premier) Manuel Baroso extolled publicly the Greek ‘economic miracle’ as an example of EU’s effectiveness. The European Commission approved every single budget submitted by the Greek government from 2002 to 2009, including the pre-budget report of 2008 that forecasted a deficit in the balance of payments of 2.8 percent for the year ahead. Since 2009, lessons seems to have been learned, as data are now scrutinised on a country specific case when budgets are submitted for approval in Brussels.

This blatant lack of discipline was the outcome of deep-rooted mistrust between hard line countries (and institutions) such as Germany, Austria, the Netherlands, Finland and the ECB on the one hand, and the European Commission together with France, Italy, Belgium and Spain on the other. As a result, the lack of the Commission’s fiscal discipline meant that problems in Greece (and other Eurozone countries) were not detected in time. From this perspective, assigning blame to Greece alone, is single sighted. Indeed, by 2009 most Greek debt was in the hands of French banks.

**Access to capital markets**

By spring 2010, assigning blame was meaningless, as events unfolded rapidly and time was of the essence. When Greece lost access to capital markets the EMU’s lack of institutional arrangements became apparent. The creation of a ‘European Monetary Fund’, suggested as early as 1981, proved elusive, even after the creation of the single currency.
Bailouts
After very heated debates, it was ‘decided’ that the International Monetary Fund (IMF) should step in to provide support. The combined rescue effort by the ECB, the Eurozone countries and the IMF led to the first bailout that provided Greek with financial assistance equal to €110 billion. As far as Eurozone countries were concerned, the first bailout included the Greek Loan Facility, consisting of 16 bilateral agreements between Greece and the other countries of the Eurozone. This was the only available option as there were no Eurozone institutions in place to support countries in need, and as such it differentiates the first bailout from the second and third. It also reflects the incomplete structure of the Eurozone. The Greek Loan Facility equalled €52.9 billion, and as such it came to almost half of the first bailout.

A second bailout of €151.6 billion was approved in November 2011, following the collapse of the government, applicable from 2012. A third bailout of €86 billion was approved in June 2015, following a referendum that rejected a similar deal, a week earlier. €11 billion aimed for bank recapitalisation were transferred from the second to the third bailout, reducing the value of the second bailout to just over €140 billion. All three bailouts were/are equally rigid in nature, and have led to an unprecedented and unanticipated peacetime economic (and social) destitution for a high proportion of the population. The draconian fiscal cuts have led to a 26% reduction of GDP from its 2009 value and unemployment in excess of 20 percent since 2012, with youth unemployment exceeding 50 percent during the same period. On the other hand, the bailouts fully cover Greece’s financial needs up to 2022, so a return to growth in the next couple of years could enable fiscal sustainability. A brief summary of the Greek bailouts in presented in Tables 1 and 2. A total of €336.6 billion has been provided to the Greek state, in return for fiscal cuts in wages, pensions, health expenditure and overall government spending. In table-2, the Greek bailouts are placed in an EU perspective that is in relation to bailouts provided to other countries. In the case of Spain, there was no official bailout, as the help was provided as extra liquidity to the Spanish banking sector. In the case of Cyprus, there was officially no bailout, as the term used was bail-in, as depositors of large amounts were ‘asked’ to participate in the scheme. All countries but Greece have successfully concluded their programmes of fiscal consolidation. The election of the radical left Syriza party and the formation of a coalition government in March 2015 derailed the
programme up to end of the year. A successful conclusion to the prolonged negotiations has led to the third bailout and the (at least partial) restoration of confidence.

### TABLE-1: GREEK BAILOUTS (€ billion)

<table>
<thead>
<tr>
<th>Year</th>
<th>Institutions</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>Eurozone - ECB - IMF</td>
<td>110</td>
</tr>
<tr>
<td>2012</td>
<td>EFSF - ECB - IMF</td>
<td>140.6</td>
</tr>
<tr>
<td>2015</td>
<td>ESM - ECB - IMF</td>
<td>86</td>
</tr>
<tr>
<td></td>
<td></td>
<td>336.6</td>
</tr>
</tbody>
</table>

### TABLE-2: EU AID (€ billion)

<table>
<thead>
<tr>
<th>COUNTRY</th>
<th>BAILOUT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Greece</td>
<td>336.6</td>
</tr>
<tr>
<td>Ireland</td>
<td>85</td>
</tr>
<tr>
<td>Portugal</td>
<td>78</td>
</tr>
<tr>
<td>Cyprus</td>
<td>16</td>
</tr>
<tr>
<td>Spain</td>
<td>44</td>
</tr>
<tr>
<td></td>
<td>559.6</td>
</tr>
</tbody>
</table>

As mentioned, the first bailout has to be differentiated from the second and third, due to the nature of the financial sources. The second and third bailouts were/are provided by, the newly created European Financial Stability Facility (EFSF), the ECB and the IMF. The EFSF was replaced by the European Stability Mechanism in 2013 and was endowed with €540 billion to cover the financial needs of Greece, Ireland and Portugal. The funds were not raised from taxation but as bonds in capital markets.

**Debt or development?**

It has to be noted that the overwhelming majority of the financial help to Greece, and the full financial assistance to the rest of the countries, was not directed for investment projects (e.g. infrastructure) but for servicing national debt. This issue is vital and has led to growing resentment between Greece and other Eurozone countries such as Germany, Finland,
Austria and the Netherlands. Numerous Greek authorities have pointed to the fact that the overall debt is impossible to service and there is a need for debt relief, so that the aid can be directed to where is needed most, that is to the real sector of the economy. In essence, they criticise the nature of the assistance, in the form of bailouts to European (in particular French) banks that were heavily exposed to Greek debt. Further, the perception of ‘hard-working’ North Europeans rests on assumptions that are not justified. Out of the €52.9 billion Euros under the Greek Loan Facility, €22.66 billion came from Germany. This is the bill to German taxpayers. According to the author’s calculation’s, with Germany’s labour market almost equal to 40 million people, this comes down to a rough estimate of €566.5 per each German worker (the estimation excludes pensioners). This is a cost only if Greece defaults and does not repay.

As high as this amount may be, it is against the background of immense current account surpluses that Germany enjoys due to factors such as hard work, efficient production lines, IT, a strong industrial base, social consensus, and its Eurozone membership. Germany’s euro participation ensures South Eurozone countries cannot devalue, and at the same time the low value of the Euro makes German products very competitive in international markets. As a result, in 2014 Germany registered a record current account surplus equal to €215.3 billion, or, alternatively equal to 7.4 percent of GDP. In 2015, current account surpluses were, further increased to 8.5 percent of GDP. To put in context, just in 2014 alone, Germany’s surpluses were almost 10 times higher than the country’s financial assistance to Greece (€215.3 billion in relation to €22.66 billion).

**A final comment**

To conclude, it is beyond any shadow of doubt that Greek (and EU) authorities were responsible for the emergence of the country’s debt. However, the pace and magnitude of fiscal cuts implemented since 2010 could have been spread out and have been less severe regardless of the lack of appropriate institutional arrangements. Ideally, it should have been preceded by a debt hair-cut, so that any financial assistance was directed to the real sector of the economy, instead of repaying French or other European banks that purchased heavily Greek debt in the past. Averting the collapse of the European banking sector is an appropriate objective. The distribution of the costs while doing so should not be so uneven among Eurozone member states.
Dimitrios Syrrakos is senior lecturer in the Department of Accounting, Finance and Economics at Manchester Metropolitan University

**Key points**

1. Countries in the Eurozone experienced the global recession very differently, partly because of the state of their national debt.

2. A condition of the Maastricht Treaty concerned the debt-to-GDP ratio of member countries on joining the single currency, but 3 countries joined with high ratios.

3. In the Eurozone, individual countries cannot use monetary policy independently.

4. Successive Greek governments displayed fiscal laxity, together with large deficits in the current account of the balance of payments.

5. In the 2000s, EU policy was more related to aggregate data than to the situation facing individual countries.

6. Greek debt continued to increase, and it received the first of three bailouts in 2010.

7. The bailouts were more geared towards addressing the problem of national debt than to enabling the recovery of the economy.