Revival of European Economy- A Tougher Time for Greece

***Dr. G. Vincent**

*Assistant Professor in Commerce, St. Joseph's College, Trichy-2, Tamil Nadu

Abstract

Economic activities of a country are an important factor to decide its growth and development. Good economy is characterized by low inflation, larger GDP, High purchasing power and full employability. Sound financial system is what each country should have. The flaw in the financial management will often lead to crisis or Struck or Block in the economic activities. The great depression 1930, Asian crisis and World Recession are the examples of crisis. The recent crisis had left a large impact on every country. And the most affected economy out of US crisis is the European economy in general and Greece in particular. Therefore, this paper examines the causes of European crisis and evaluates the PIGS economies and throws lights on various economic factors of those countries. It makes an attempt to highlight the economic profile of Greece which has been the bad victim of European crisis. Statistics are taken from IMF and CIA World Fact Book 2010 for the empirical analysis. It traces the evolution of Greece Debt crisis. Finally, it analyses the strengths and weakness of Euro and Impact of Euro currency on Greece recovery.

Keywords: FDI, Public Debt, Recession

Introduction

"Greece sneezes and Portugal catches a cold. Portugal coughs and Spain falls ill, Spain runs a fever and Italy comes down with flu"[1] Anyone watching the world economy will very well understand the above maxim. The current crisis is yet to have cathartic impact of the slump of 1930s when the economic cost was far higher and links between the failure of the old laissez-faire model and the draft to political extremism were plain.[2] The sick ones already plagued with thing debt levels and bloated state budgets, do not need a carrier. Capital flights from these countries are not evidence of contagion, said Ms.Anna Schwartz. Ms.Schwartz punctured the notion that financial crisis passes from initial sources to innocent victims. Nations are vulnerable because of their home – grown economic problems.[3]

The Greek economy was one of the fastest growing in the euro zone during the 2000s; from 2000 to 2007, it grew at an annual rate of 4.2% as foreign capital flooded the country.[4] A strong economy and falling bond yields allowed the government of Greece to run large structural deficits. Greece enjoys a high standard of living and "very high" Human Development Index, ranking 29th in the world in 2011,[5] After the introduction of the Euro Greece was initially able to borrow due to lower interest rates government bonds could command. Since the introduction of the Euro, debt to GDP has remained above 100%. The global financial crisis that began in 2008 had a particularly large effect on Greece. Two of the country's largest industries are tourism and shipping, and both were badly affected by the downturn with revenues falling 15% in 2009.[6]

PIGS in Muck (Portugal, Italy, Greece and Spain)

"This was how using the acronym "PIGS"- the Portugal, Italy, Greece and Portugal"-the financial Times had titled an edit on August 31, 2008. The countries constituting PIGS are in trouble. The Contagion theory is sweeping the Euro zone, where Greece debt crisis is infecting neighboring countries and threatening to make its way across the Atlantic to US shores[7]

Public Debt

If Greece's Public debt rated to GDP is risky over 125%, Italy (over 115%) is as bad. If Greek is external, debt to GDP is bad at 187%; Portugal (218%) and Spain (229%) are far worse.[8]

Table -1 Public Debt (% GDP) of PIGS 2010 Ranking

Countries	Rank	Public debt (% of GDP)
Portugal	18	75.20
Italy	7	115.20
Greece	8	108.10
Spain	31	59.50

Source: CIA World Fact Book 2010

The above table reveals the status of public debt (% of GDP). Portugal is in better position in world rankings. Greece occupies the 8th rank and the worst case is Spain which stood at 31st place. PIGS had no control over its debt. In case of Spain, rating agencies have actually downgraded the government bonds from AAA+ to AA++ and from BBB + to A-.

Direct Foreign Investment At Home

The direct foreign investment of any country represents the confidence of other countries on its economy and industry. If the economy is a superior one, it will attract foreign investment. The in- flow of foreign capital will be more and continue till the economy is good. The year 2000 was remarkable year for most European countries, because the Euro currency was accepted as uni-currency. The impact was marvelous as it attracted most of the world's direct foreign investment. The following table gives the stock of Direct Foreign Investment of PIGS nations.

Table 2 Stock of Direct Foreign Investment at Home of PIGS 2010 Ranks

Countries	Rank	Direct Foreign Investment at Home
Portugal	29	$ 120, 600,000,000
Italy	12	$ 386, 700,000,000
Greece	53	$ 43,000,000,000
Spain	8	$ 649,900,000,000

Source: CIA World Fact Book 2010

The above table exhibits the world rank of stock of Direct Foreign Investment of PIGS nations. It is clear that Spain is the topper among the PIGS country with 8th Rank. The second topper is Italy with 12th Rank. Greece occupies the 53rd Rank. So, one can conclude that least the rank more confident the economy is.

Stock of Direct Foreign Investment-Abroad of Pigs 2010 Ranks

Again, Stock of Direct Foreign Investment is an indicator of how sound one's investment is or surplus fund is. The following table lists the ranking of PIGS nations in world's rank in Stock of Direct Foreign Investment-held abroad.

Table 3 Stock of Direct Foreign Investment-Abroad of PIGS 2010 Ranks

Countries	**Rank**	**Direct Foreign Investment at Home**
Portugal	70	NA
Italy	12	$ 610, 500,000,000
Greece	34	$ 29,550,000,000
Spain	10	$ 633,300,000,000

Source: CIA World Fact Book 2010

The above table clearly states that Spain remains strong in terms of its direct foreign investment held abroad as it has recorded 10th rank. Italy seems to be better. Greece had invested abroad a sum of $ 29,550,000,000, and it occupied 34th rank. The worst is Poland and it ranks 70th position. Thus if one in every fifty Greeks is poor, it is one in every fifth Portuguese and Spanish is poor.[9] The PIGS club has expanded with Ireland first and Great Britain next making PIIGS (adding another "I" for Ireland and another "G" for Great Britain.

Greece -Economic Profile

Greece has a capitalist economy with the public sector accounting for about 40% of GDP and with per capita GDP about two-thirds that of the leading euro-zone economies. Tourism provides 15% of GDP. Immigrants make up nearly one-fifth of the work force, mainly in agricultural and unskilled jobs. Greece is a major beneficiary of EU aid, equal to about 3.3% of annual GDP. The Greek economy grew by nearly 4.0% per year between 2003 and 2007, due partly to infrastructural spending related to the 2004 Athens Olympic Games, and in part to an increased availability of credit, which has sustained record levels of consumer spending. But growth dropped to 2.9% in 2008. The economy went into recession in 2009 and contracted by 2.5%, as a result of the world financial crisis, tightening credit conditions, and Athens' failure to address a growing budget deficit, triggered by falling state revenues, and increased government expenditures. Greece violated the EU's Growth and Stability Pact budget deficit criteria of no more than 3% of GDP from 2001 to 2006, but finally met that criterion in 2007-08, before exceeding it again in 2009 by 12.7%. Public debt, inflation, and unemployment are above the Euro-zone average; debt and unemployment rose in 2009, while inflation subsided. Eroding finances prompted major credit rating agencies in late 2009 to downgrade Greece's international debt rating, which has led to increased financial instability.[10]

Table 4 Major Economic Indicators of Greece

Economic Factors	2007 (31-12-2007)	2008 (31-12-2008)	2009 (31-12-2009)
GDP (PPP)	$ 338.1	$347.9	$339.2
GDP-real growth	4%	2.9%	-2.5%
GDP- Per Capita (PPP)	$ 31,600	$ 32,400	$ 32,100
Unemployment rate	NA	7.65%	8.9%
Public debt	NA	97.4% of GDP	108.1% of GDP
Current account balance	NA	$ -51.53 billion	$ -40.82 billion
Country's exports	NA	$ 29.14 billion	$ 18.64 billion
Debt external	NA	$ 504.6 billion	$ 552.8 billion
Stock of direct foreign investment- at home	NA	$ 36.7 billion	$ 43.07 billion
Stock of direct foreign investment- at abroad	NA	$ 32.44 billion	$ 29.55 billion
Exchange rate- EUR per US dollar	0.7345	0.6827	0.7338

Source: CIA World Fact Book 2010

Tim Nash, from Midland's Northwood University says, "If we don't start to look seriously at how we reduce our public debt and our national debt, this could be something we face 5 to 10 years down the line. Greece has one of the highest tax burdens in the industrialized world. As far as borrowing goes, Greece's public debt is 113% relative to its gross domestic product. Its national debt is even higher". Nash says

Why Greece Fails?

Greece is part of the European Union, which uses the Euro. Greece does not have its own currency so it cannot be inflated. It's being forced to cut spending, which has led to rioting in the streets. The Greek government's decision this month to come clean on the true state of its finances has shaken the European Union and posed a life-and-death question for the world's most powerful trade bloc: Greece, followed closely by at least four other EU nations, is so comprehensively over its head in debt that international markets have pounced, driving up the cost of Greece's government borrowing to the point where default — the international financial term for going flat bust — is a very real possibility. Even Greece's 2007 budget deficit was no higher, a share of GDP, than the deficits in US ran in mid 80s, while Spain actually ran a surplus. All these countries were attracting large inflow of foreign capital. There came global financial crisis. "Those inflows of capital dried up; revenues plunged and deficits soared; and membership in the Euro which had encouraged markets to love crisis countries not wisely but too well turned into a trap".[11] Greece is a spot in EU and a dot in the world, yet a dot threatening to cause a global crisis. The tiny Greece is a symbol of larger PIIGGS. And if Greece goes, others may follow. According to IMF Report on Global Financial Stability (April 2010), "out of the total capital flows of $ 24.8 trillion – over 50 per cent have been linked in the Euro."[12] The following table explains the events of how the Greece had undergone the debt crisis.

Table 5
Event of Greece's Debt Crisis

Date	Event
October 2009	A new Greek is formed after the election, led by PASOK.
November 2009	New budget reveals a deficit of 12.7% of GDP.
December 2009	Fitch Ratings cuts Greece's rating to BBB+ from A- With a negative outlook
January 2010	Greece Unveils the stability and Growth Program which aims to cut deficit from 12.7% in 2009 to 2.8% in 2012. And 5-year bond issue is five-times oversubscribed but yields and spreads rise.
February 2010	Government extends public sector wage freeze to those earning less than EUR 2000 a month
	EU Commission backs Greece Stability and Growth Program and urges it to cut its overall wage bill
March 2010	New Public sector Wage cuts and tax increase is passed and estimated to generate savings of EUR 4.8bn.Measures include increasing VAT by 2% to 21%, cutting public sector salary bonuses by 30%, increase on Fuel, tobacco and alcohol consumption taxes and freezing state-funded pensions in 2010.
	On 11 March Public and Private sector workers strike
18 March 2010	Greek Prime Minister Papandreou warns Greece will not be able to cut deficit if borrowing costs remains high as they are and may have to go to IMF.
May 2010	Fourth general strike against wages in Greece, Fitch downgrades Spanish government bonds one notch from AAA+ to AA+.

Source: Self-Prepared from Various Sources

Lessons from US

In 1946, US having emerged from World War II had federal debt equal to 122 per cent of GDP. Yet investors were relaxed. Over next decade, the ratio of US debt to GDP was cut nearly in half, easing any concerns people might have had. (about our ability to pay what we owed). And debt as a percentage of GDP continued to fall in the decades that followed hitting a low of 33 per cent in 1981. "At the end of 1946, the federal government owned $ 271 billion; by the end of 1956 that figure had risen slightly to $274 billion".[13]

Euro- the Worrying Factor

The year 2000 should have been a remarkable year for the European countries, as they have introduced a Euro as a common currency. Euro underwent the trial period of two years wherein the uni-currency was used by banks and money markets. It was only in 2002 when the euro currency was made available to the common folk to buy a candy or a cigarette. It has been very successful. Put it precisely, most of the exports and imports were shifted from dollar to euro. In the initial eight of euro, the euro zone created on an average one million new jobs each year-five times more than the average in the previous year. The euro has been a magnificent success.

Instead of struggling to maintain parity with the dollar, it has soared to greater heights.[14] However, the dollar was probably overvalued then maintained by the good performance of asset markets. But beginning 2002, dollar began to slide downwards as a response to the yawning US current account and budget deficits. To have an idea of the gravity, it must be stated here that US Current account deficit stands at around 5% of her GDP as of now, thanks to Mr. Bush's Series of tax cuts (though designed in part to lift the economy out of recession) and profligate spending. Given the size of US economy, this would be equal to the combined GDP of many small nations. In the midst of this commotion, the European Union has also been struggling to protect the Euro, the currency used by 16 of its 27 members. The massive $750-billion package put together by European Union governments is an effort to save the common European currency, the Euro, from collapse. This package, which includes €440 billion in guarantees from euro zone countries,€ 60billion from the European Union budget and €250 billion from International Monetary Fund, is designed to provide liquidity to those European countries that run into difficulties raising money in the financial markets.[15] The Euro has depreciated by over 11 per cent since January against dollar (from $1.44 to $1.27).Against the rupee, the euro has depreciated by over 13 per cent (from Rs.66.48 to Rs. 57.81).[16]

Conclusion

The only thing that could be seriously reducing Greek pain would be an economic recovery, which would both generate higher revenues, reducing the need for spending cuts, and creates jobs.[17] Clever Polish policymakers have understood the message and changed their rhetoric to saying they expect to join the Euro in 2015 at the earliest**," he said.** Analysts expect the European Commission and the ECB to be stricter than ever in applying the criteria for membership and insisting that candidates must first achieve real, sustainable economic convergence with the Euro area. That means taking more account of previously neglected indicators such as current account balances and wider measures of competitiveness.

Iceland came knocking at the door of the Euro zone in search of a life raft after its banks collapsed in October 2008 but was told it must first apply for EU membership. Entry talks have yet to begin and could be complicated by a standoff with Britain and the Netherlands over the Icescape compensation issue. The Polish and Czech governments illustrated the receding Euro horizon this week when they approved convergence plans that appear to delay membership until the second half of the decade. Poland, which suffered embarrassment, last year when it had to ditch an over-optimistic 2012-entry target, set no new date, while the Czech Republic is now aiming for 2016-17. The depreciation of Euro in the international market further add fuel to the down turn of Greece's economy. Most of the international traders stun the EU that they would switch back to US dollar the signatory currency of the international trade. After weeks of brinkmanship, bad blood and missed deadlines, a Greek debt deal may finally be within reach. European finance ministers will meet on Monday to decide whether to approve a €130 billion ($170.9 billion) bailout package designed to bring Greece's debts down to 120% of GDP by 2020.[18]Therefore, Greece should revamp its financial system carefully and bounce back. Will Greece bounce back?

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