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# The Greek Financial Crisis: An Overview of the Crisis in Entirety and Proposed Measures: Recommended Solutions and REsults

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# The Greek Financial Crisis

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*An Overview of the Crisis in Entirety and Proposed Measures: Recommended Solutions and Results*

**Androniki Podaras**

**Spring 2012**

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## **Abstract**

This paper examines the Greek financial crisis from 2009 in entirety and analyzes the best option for economic growth from this point forth. The history and culture of Greece is discussed, along with a background of the economy and several economic policies that led to the increased debt levels and the poor economic health of the country. The Gross Domestic Product of Greece and the inflation levels are analyzed to show the changes and signs of poor economic health, and one that was affected by the entry into the Eurozone in 2000.

Then, I discuss how this led to the 110 billion euro bailout package the country received in May of 2010 with funds from both the IMF and the EU. The package was designed to prevent Greece from defaulting on its massive amounts of debt, and intended to cut the public deficit and national debt in the upcoming years. This package only postponed the country's deeply embedded financial woes and a possible default until it received a second bailout package. In March of 2012, Greece reached a debt-swap deal which halved its debt-load, and also received the second bailout worth 130 billion euros. Debt was expected to fall, GDP contract, and unemployment rise, all in reaction to the new measures and further cuts. Since this bailout package is recent, it is difficult to measure the effectiveness of it so far, but is more realistic in aiding the economy than the first bailout package.

After discussing the two bailout packages, I use Argentina as a country of comparison regarding its own crisis and default in 2001. Like Greece, Argentina accumulated an unpayable debt because loans were recklessly taken and offered. Greece and Argentina share various similar features in relation to their economies, policies, and crisis; the difference is the solution as of yet that is different, as Argentina defaulted on its large amount of debt and Greece accepted

a second bailout. The deep comparison to Argentina is very important, and many lessons can be taken from the country, since its economy excelled after defaulting on debts and dropping the peg to the dollar. Other than Argentina, other countries with similar situations and crises are discussed, such as the neighboring Eurozone periphery countries of Spain and Ireland. They shared some economic difficulties and recession also partly due to the Euro and the halt of capital flows after fears of risk of default, regardless of how well they had managed their finances. The common joint currency also played a very large role in creating crisis, and not only some irresponsible behavior of the countries. Outside of the Eurozone, another case is made regarding the financial crisis in Mexico which is also somewhat similar to that of Greece.

After analyzing similar crises, I discuss the concept of odious debt, the countries it was applied to, and that it can possibly be used in Greece's case by showing that a large amount of the debt incurred was illegitimate. Lastly, the current economic situation of Greece is reviewed, along with what options the country has- defaulting and leaving the Eurozone, or accepting and abiding by the terms of the second bailout, and getting the private sector involved. The second bailout package is the best option to take when comparing it to a major default, which would be disastrous on the Greek economy and for the people, and also much more difficult than in Argentina's case. Some of the massive amounts of debt should also be declared as odious if this can be proved by conducting a thorough audit. The second bailout will hopefully steer the economy in a better path and lead to overall economic growth in the years to come, although it has some harsh measures many Greeks are having difficulty accepting. To conclude, the road to recovery will not be easy, but it is possible even without a default at this point, as was done in Argentina. Reforms have to be made, new opportunities taken, the bureaucracy simplified, the corruption in government mitigated, and a change of lifestyle for many Greek people.

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## **I. Introduction**

The purpose of this thesis is to review and analyze the financial crisis in Greece from the period of 2009 and recommend a solution for it. This thesis will provide an overall background and short history of Greece, along with the roots of the financial crisis, and what led to the depth of it until this day. I will not only discuss economic problems of Greece, but also relate them to those of other countries that have experienced similar problems and crises, and use these comparisons to propose possible lessons for Greece and recommended measures. The two bailout packages of 2010 and 2012 will be reviewed and analyzed, and I will show how each one has affected or can affect Greece in the future. Lastly, each option for Greece will be weighted for dealing with the crisis and also compared. The options will be reviewed, along with how each one can help or hurt the country's economic situation. Lastly, the option recommended is staying in the Euro, avoiding default, and dealing with the measures proposed in the most recent March 2012 bailout. I also recommend declaring some of the debt owed as odious.

## **II. Background of Greece**

### **i. The History & Culture of Greece**

Greece is a country with many years of history, and is also one of the oldest civilizations. It was under slavery for about 400 years under the Ottoman Empire. After the victory following the revolution of 1821, the Greeks gained their freedom, and in the 1830s the modern Greek state was established. The revolution of 1821 marked the beginning of borrowing for Greece, but also for a short period of time the country assumed the role as lender to Germany during German



Occupation in World War II. After Occupation, it resumed the role of borrower and started borrowing heavily again.

After this, there were a number of other wars the Greeks fought including the 1912-13 Balkan Wars that ended up increasing the size of Greece as more territory was gained, World War I, a war involving Asia Minor in 1921, World War II in 1940, and then six years of civil war that started in 1946. The last was a conflict in 1974 between Cyprus and Turkey, a conflict that exists until this day. <sup>1</sup>

While still a poor country, “Greek leaders sought to protect, and sooth, the war-stricken population by finding alternative ways to help improve their livelihoods”. A welfare state emerged which brought an “automatic, indexed salary schedule instead of annual pay increases based on market indicators (such as productivity). <sup>2</sup> A worker's base salary would be further adjusted to include subsidies and transfers of all kinds, based on factors such as marital status and number of children. This also included the infamous 13th and 14th monthly salaries, or salaries for non-working months. Although various measures were taken, and what many would have considered benefits, the average monthly salary in Greece was still much below the average European Union monthly salary.

Greece's modern history is “marred by conflicting factors: a rapid evolution of the state, economic growth and governance based on legal institutions that were mainly imported.” <sup>3</sup> Despite the many problems Greece has faced and harsh conditions, along with a tough economic environment and limited opportunities, Greece has managed to grow. Inflation was 15.6 % for

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<sup>1</sup> Panaritis, Elena. "The Historical Roots of Greece Debt Crisis." *the Globalist*. N.p., 2011. Web. 3 Apr 2012. <<http://www.theglobalist.com/StoryId.aspx?StoryId=9131>>.

<sup>2</sup> Ibid.

<sup>3</sup> Ibid.

January 1990, managed to drop to 6.6% in February 1997, and dropped even further after that. Some of the factors contributing to the vast improvement in inflation included “austerity measures which have reduced wage growth, a determination to keep the exchange rate stable against major European currencies, the sale of inefficient state run enterprises and a willingness amongst policy makers to avoid inflationary policy measures”.<sup>4</sup>

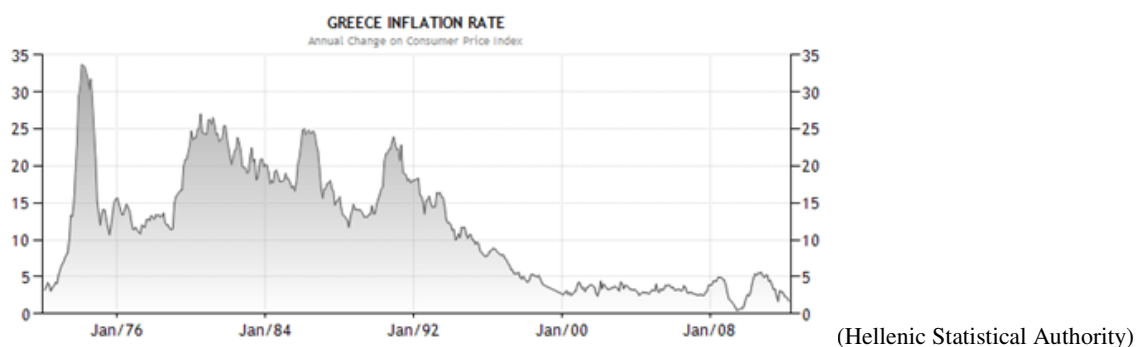


Figure 1: Greece’s Inflation Rate, Annual Change on Consumer Price Index

Between 1961 and 1972 Greek annual inflation averaged less than 2.5 %, and the high inflation occurred due to sharp oil price increases in 1973 that drove Greek as well as global inflation rates up.<sup>5</sup> After this, Greece's Gross Domestic Product was growing at a steady rate every year,<sup>6</sup> one of the fastest growth rates in Western Europe. Industrial production also grew annually, and for the first time in Greece’s history, manufacturing exports were greater than agricultural exports.<sup>7</sup>

<sup>4</sup> Haralambopoulos, Akis. “Review of the Greek Economy”. Hellenic Resources Institute, Inc. 1997. Web. 5 March 2012. <<http://www.hri.org/forum/econ/greece97.html>>.

<sup>5</sup> Ibid.

<sup>6</sup> "Greece GDP-real growth rate." *indexmundi.com*. Indexmundi. 2011. Web. 10 March 2012. <[http://www.indexmundi.com/greece/gdp\\_real\\_growth\\_rate.html](http://www.indexmundi.com/greece/gdp_real_growth_rate.html)>.

<sup>7</sup> Frucht, Richard C. . *Eastern Europe: An Introduction to the People, Lands, and Culture*. 1. Santa Barbara, California: ABC-CLIO , 2004. 877.

## ii. Greece GDP and Country Debt: Mirror of Financial Health

The Gross Domestic Product, or GDP, in Greece expanded by .20% in the first quarter of 2011 over the previous quarter, possibly due to the bailout package. From 2000 until 2011, Greece's average quarterly GDP growth was about .46 %; it reached a high of 3.8% in March of 2003 and a record low of -2.8% in December of 2010. Prior to the financial crisis, Greece had managed to achieve a fast-growing economy after the implementation of stabilization policies in the past couple of years. Greece has a predominantly service economy, which accounts for over 70% of GDP. <sup>8</sup> To get a better idea of Greece's debts and budget deficit, here is a graph to compare them to those of other European countries projected in 2009.

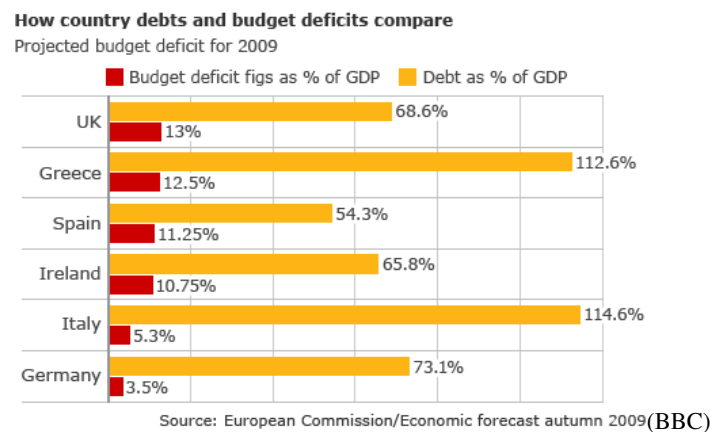


Figure 2: How Country Debts and Budget Deficits Compare: Projected Budget Deficit for 2009

- ❖ *As the graph portrays Greece projected budget deficit was higher than that of any other member of the Eurozone.*

The national debt started to rise in the 1980s. High levels of borrowing in Greece have to do with social and class structure in Greece and the form the Greek economy has assumed over

<sup>8</sup> "Greece GDP Growth Rate". Trading Economics. 2011. Web. 3 April 2012. <<http://www.tradingeconomics.com/greece/gdp-growth>>.

last few decades, and also with a non-effective and unfair system of taxation.

### **iii. Economic Policies Throughout the Years**

The spending and borrowing of Greece started with various different policies throughout the past decades under different political regimes. Prime Minister Andreas Papandreou (who served two terms from 1981-1990) implemented an expenditure program that included various excessive expenses, which in turn increased the budget deficit and the public debt and did not produce any revenue increases.

His policies received positive and negative reviews; some pointed out that economic indicators worsened during his term, and others argued they were successful, as they increased the purchasing power of many Greeks (whose personal incomes were “growing by 26% in real terms during the course of the 1900’s”).<sup>9</sup> Papandreou's increased spending was deemed by many as necessary in order to get the country back on track and ensure a better future for many Greek people- all part of “a society that was still deeply divided by the brutal memories of the Civil War and the right-wing repression that followed”.<sup>10</sup> The election of the Papandreou Government in 1980 resulted in an unsustainable rise in wages and large budget deficits (which resulted in extraordinarily high inflation). After almost a decade of Papandreou’s policies, inflation in Greece became deep-rooted. Economic policies since the late 1980's have recognized the shortcomings of Greece's inflation performance, and partly as a result of pressure from the European Union (EU) has led to policy measures aimed at bridging the gap in inflation between

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<sup>9</sup> Gramsci Foundation, Sassoon, Donald. *Looking Left: Socialism in Europe After the Cold War*. London: New Press, 1998. Print.

<sup>10</sup> Nikolaou, Nikos. "Andreas Papandreou: Largest Piece of Advice of Andrea about the Economy was the Change During". 25 July 1999. Web. 3 Apr. 2012. <<http://www.tovima.gr/politics/article/?aid=112956>>.

the EU and Greece.<sup>11</sup> Other Greek conservatives argued that there were not enough funds spent on education and healthcare, and generally for well-being of the Greek people. Papandreou failed to increase corporate and high income taxes, and looked after various companies' interests and their owners. Public deficit and sovereign debt increased dramatically.

Konstantinos Mitsotakis followed as Prime Minister of Greece in 1990, and the Greek government continued to borrow, with debt skyrocketing representing the highest increase rate in Greek history. On February 7<sup>th</sup>, 1992, two years after the start of Mitsotakis' term, the Maastricht Treaty was signed by the members of the European Community and it created the European Union, which led to the creation of the single European currency, the euro.

Costas Simitis took office in 1996 as Prime Minister, and believed in modernizing the country, something most of his policies reflected. He focused on the idea of increasing and improving public investment and infrastructure (large-scale infrastructure projects included the Eleftherios Venizelos Athens International Airport, the Rio-Antirio bridge, the Athens Metro, and the Egnatia Odos). During the period of his term, data showed that inflation decreased, public deficits diminished, GDP increased at a high rate, and labor income increased also at a high rate per year. However, the data presented by Simitis' government was criticized as being falsified and the numbers greatly inflated; they were even audited by the government of New Democracy (the main center-right political party and one of the two major parties in Greece) in 2004. Eurostat concluded in 2006 that the public deficit of the Greek economy amounted to a number almost double that presented by Simitis' government. The results of the audit concluded that the PASOK administration of Simitis used different accounting methods, especially for

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<sup>11</sup> Haralambopoulos, Akis. "Review of the Greek Economy". Hellenic Resources Institute, Inc. 1997. Web. 5 March 2012. < <http://www.hri.org/forum/econ/greece97.html>>.

calculating the military expenses during its term. The government of New Democracy used the revised data as a way of criticizing the previous government for economic policy and falsifying accounts and numbers, especially the public deficit, which among other criteria was used as a basis on which Greece was accepted into the Eurozone.

Greece officially joined the single currency Euro on Jan. 1, 2001, with an official conversion rate of 340.75 drachmas to the euro, matching its then central parity rate in the European exchange rate mechanism. Although Greece sought to join the euro in May 1998 it did not qualify. There were worries about Greece from the beginning, as the country has an annual inflation rate of 2.6 percent, which was higher than that of most other European countries. The government in Athens “pledged to restrain spending and work toward achieving a budget surplus” by the following year. Greece had a lot of catching up to do, as economic output per head in other countries was on average 30% higher.<sup>12</sup>

Another major issue during Simitis' term related to corruption, which in Greece is something that is definitely not unheard of and has proven quite common. To make matters worse, Simitis also had rejected the rival political party, New Democracy's, bills for “accountability and transparency” in regard to governmental expenditures and other decisions.<sup>13</sup> Now, Simitis may have been helped by creative accounting, the fall of European interest rates, and economic growth, but overall, during his reign, the decrease in debt was very slight. Kostas Karamanlis, Prime Minister from 2004-2009, also decreased capital taxation by 10%, and under the mass of the huge costs, which were estimated at €7 billion, the deficit went up to 5.3% as a percentage of GDP (almost twice the 3% allowed by the European Union). Total cumulative debt

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<sup>12</sup> Barry, James. “EU Invites Greece to Join The Single Currency Fold”. 20 June 2000. Web. Web. 20 February 2012. <[http://www.nytimes.com/2000/06/20/news/20iht-A1\\_2.html](http://www.nytimes.com/2000/06/20/news/20iht-A1_2.html)>.

<sup>13</sup> “Rejecting the Proposal of the New Democracy for More Transparency”. 25 November 2003. Web. 21 January 2012. <[http://www.bbc.co.uk/greek/news/031125\\_vouli.shtml](http://www.bbc.co.uk/greek/news/031125_vouli.shtml)>.

was as high as 112% of GDP or 184 billion euros (about 50,000 euros for each Greek household). Before his election, the previous Socialist government had predicted a 1.2% deficit, with total debt under 100% of GDP. He stated that "social policy was done with borrowed cash, military spending did not show up on the budget, debts were created in secret".

Then, Prime Minister George Papandreou, finally led Greece into the lap of foreign lenders. Upon inauguration in 2009, Papandreou's government revealed the budget deficit of 12.7% of GDP, four times more than the Eurozone's limit, and a public debt of \$410 billion.<sup>14</sup> Greece already had an unemployment rate of 10% and the country's debt rating was BBB+ (the lowest in the Eurozone).<sup>15</sup> Papandreou dealt with the main financial problems of the economy by promoting austerity measures, reducing spending, increasing taxes,<sup>16</sup> halting additional taxes, and introducing measures for controlling and trying to stop tax evasion (which is ever present in Greece and has cost an extreme amount of tax revenue loss)<sup>17</sup>. In addition to this, he reduced the number of workers employed in the public sector, which of course in Greek fashion led to nationwide strikes<sup>18</sup>. It was criticized by the EU and the Eurozone members as it was seen as not reaching and obtaining the required goals, including the country trying to reduce its public deficit from 12.7% - more than four times the level that single currency rules allow.<sup>19</sup>

In April 2010 Papandreou asked the EU partners to use a support mechanism, which was

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<sup>14</sup> Crumley, Bruce. "In Paris and Berlin, Fury Over a Greek Bailout." 16 February 2010. Web. 1 Apr 2012. <<http://www.time.com/time/world/article/0,8599,1964443,00.html>>.

<sup>15</sup> Smith, Adam. "Why Greece Could Be the Next Dubai". 9 December 2009. Web. 20 February 2012. <<http://www.time.com/time/business/article/0,8599,1946594,00.html?iid=sphere-inline-sidebar>> .

<sup>16</sup> Tsiantar, Dody. "Greek Tragedy: Athens' Financial Woes." Time Magazine. 15 February 2010. Web. 20 January 2012. <<http://www.time.com/time/magazine/article/0,9171,1959059,00.html>>.

<sup>17</sup> "No Tax Please, We're Greek." BBC News. 11 February 2010. Web. 3 April 2012. <[http://news.bbc.co.uk/2/hi/programmes/from\\_our\\_own\\_correspondent/8509244.stm](http://news.bbc.co.uk/2/hi/programmes/from_our_own_correspondent/8509244.stm)>.

<sup>18</sup> "Greece Hit by Nationwide Strike Over Austerity Measure". BBC News. 10 February 2010. Web. 15 March 2012. <<http://news.bbc.co.uk/2/hi/europe/8507551.stm>>.

<sup>19</sup> "Greece Told to Make More Spending Cuts". 16 February 2010. Web. 2 April 2012. <<http://news.bbc.co.uk/1/hi/business/8517499.stm>>

“an unprecedented mechanism in the history and practice of the European Union”.<sup>20</sup> The support mechanism, which was put in place by the European heads of state and government and (and expanded by Euro Group ministers), is a “European mechanism to which the IMF is associated with financing and it involves a comprehensive three-year economic program and financing conditions”.<sup>21</sup> Soon after this was done by Papandreou, Dominique Strauss-Kahn, the Managing Director of the International Monetary Fund at the time announced that Greece made a request for a Stand-By Arrangement.<sup>22</sup>

Greece's sovereign debt crisis and all the harsh measures soon led to even more strikes and widespread demonstrations. In May 2011, 77% of the people interviewed regarding the handling of the crisis said that they did not trust Papandreou as Prime Minister in handling the Greek economic crisis.<sup>23</sup>

### **III. 2010 Bailout- First Sign of Hope?**

#### **i. Overview**

In March 2010 Papandreou compared the budget crisis to a "wartime situation" and announced third round of tax rises and spending cuts totaling \$6.5 billion. Then in April and on May 2, 2010, there were fears of a possible default on Greece's debts; help was very much needed at this point, and clearly Papandreou had to take new measures regarding the ailing economy as Greece needed money and it needed it quickly. This prompted Eurozone countries to

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<sup>20</sup> Papandreou, George A. “Imperative need to activate the support mechanism

“ George A. Papandreou Official Website. 23 April 2010. Web. 1 April 2012.

<<http://www.papandreou.gr/papandreou/content/Home.aspx?d=6&rd=7739474&f=-1&rf=-1&m=-1&rm=-1&l=1>>.

<sup>21</sup> Transcript of a Press Conference. George Papaconstantinou. International Monetary Fund. 25 April 2010. Web. 2 March 2012. <<http://www.imf.org/external/np/tr/2010/tr042510.htm>>.

<sup>22</sup> “Statement by IMF Managing Director Dominique Strauss-Kahn on Greece”. International Monetary Fund. 23 April 2010. Web. 27 December 2011. <<http://www.imf.org/external/np/tr/2010/tr042510.htm>>

<sup>23</sup> “One Year After the Trial and Practice of the. Skai News. Web. 19 February 2012.

<<http://www.skai.gr/news/politics/article/169875/mnimonio-ena-hrono-meta-apodokimasia-aganaktisi-apaxiosi-anasfaleia/>>.



finally approve the \$146.2 billion (110 billion euros) three-year rescue package for the country. As part of the bailout deal, Papandreou announced a number of even more strict and austere measures. Trade unions soon called a general strike and protested. Under Papandreou, Greece promised to make major austerity cuts. The EU was to provide 80 billion euros in funding and the rest would come from the International Monetary Fund. This deal was designed to prevent Greece from defaulting on its massive amounts of debt.

The measures included further tax rises and deeper cuts in pensions and public service pay. The Eurogroup was “trying to speed up rescue efforts for Greece amid fears its debt crisis could undermine other debt-laden states that use the single currency. Anxiety about contagion (was) focused on Portugal, Spain and the Republic of Ireland.” Germany had been the most reluctant to bail out Greece and stated that Greece had to implement its new austerity programme “quickly” and “to the letter”.

Although the Greek economy was in a deep recession, it was forecasted that GDP would fall by 4% in 2010. The country's national debt during the time of the bailout was about 115% of GDP and expected to rise to 149% by 2013 before falling. Papandreou announced that active and retired public sector workers would have to deal with the budget cuts, and that they were “great sacrifices”. He also stated that “our national red line is to avoid bankruptcy” and that “no-one could have imagined” the size of the debt that the previous government, which left office last year, had left behind”.<sup>24</sup>

The austerity plan aimed to get budget cuts of 30 billion euros over three years - with the goal of cutting Greece's public deficit to less than 3% of GDP by 2014, which then stood at

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<sup>24</sup> “Eurozone Approve Massive Greek Bail-Out”. BBC News. 2 May 2010. Web. 24 March 2012. <<http://news.bbc.co.uk/2/hi/8656649.stm>> .

13.6%. Measures included “scrapping bonus payments for public sector workers, capping annual holiday bonuses and dismissing them for higher earners, discarding increases in public sector salaries and pensions for at least three years, increasing value added tax from 21% to 23%, raising taxes on fuel, alcohol and tobacco by 10%, and taxing illegal construction. Finance Minister George Papaconstantinou stated that "it is not going to be easy on Greek citizens, despite the efforts that have been made and will continue to be made to protect the weakest in society." <sup>25</sup>

German Chancellor Angela Merkel believed that Greece's austerity plans were not entirely achievable, and would even lead to other troubled Eurozone members having the same fate: “these countries can see that the path taken by Greece with the IMF is not an easy one. As a result they will do all they can to avoid this themselves”. Although the bailout required Greece to make deep cuts to its social programs, cut public payrolls, and sell state-owned property and businesses, it fell short of its goals. The initiative failed so much at succeeding that it seemed Greece would be running out of money once again. The rescue program weakened Greece’s growth, reducing government spending and salaries by billions of dollars in a country that was already in a deep recession. Private companies “closed or fired workers faster than forecast, driving unemployment beyond what the International Monetary Fund expected, and business and consumer spending fell further than anticipated, depriving the country of tax receipts. Sales of state-owned property proceeded slower than expected, and changes in economic policy also began to lag”. <sup>26</sup>

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<sup>25</sup> “Eurozone Approve Massive Greek Bail-Out”. BBC News. 2 May 2010. Web. 24 March 2012. <<http://news.bbc.co.uk/2/hi/8656649.stm>> .

<sup>26</sup> Schneider, Howard, Faiola, Anthony. 17 June 2011. Web. 20 December 2010. “Greece’s 2010 Bailout Falls Flat, Puts Nation Back on Brink of Default a Year Later”. <[http://www.washingtonpost.com/business/economy/greeces-2010-bailout-falls-flat-puts-nation-back-on-brink-of-default-a-year-later/2011/06/17/AGXijSZH\\_story.html](http://www.washingtonpost.com/business/economy/greeces-2010-bailout-falls-flat-puts-nation-back-on-brink-of-default-a-year-later/2011/06/17/AGXijSZH_story.html)>.

In October of 2010 the government announced new and tougher, austerity measures in a 2011 draft budget. Measures included new taxes and higher rate of value added tax. Then in February 2011 international lenders complained that "austerity measures so far implemented do not go far enough, and that Greece must speed up reforms to get its finances back on track".<sup>27</sup> During March 2011, IMF economists predicted that Greek unemployment would reach 15%, and they unfortunately were proven somewhat right, as it reached above 16 %. Others said the bailout only succeeded in buying time in order to avoid a possible default.

Angela Merkel also believed that private holders of European government bonds would have to accept losses if the country ran out of money. This only added fuel to the fire, as Greece shortly thereafter found it difficult to borrow in private markets, even though there were very high interest rates, as investors feared extreme losses. German officials even became concerned about "political fallout at home from spending money to bail out Greece, demanded stricter terms, including deeper cuts in public spending".<sup>28</sup>

In the summer of 2011 there was yet another strike, this time a 24-hour general strike. Tens of thousands of protesters marched to oppose the government efforts to pass new austerity laws. The worst seemed to come when the word "default" was mentioned, and during the summer in July 2011, Greek interest rates rose as many predicted the country will default. Discussions "appeared headed toward at least a short-term fix. Germany, Europe's largest economy, wanted private bondholders to make a "substantial" contribution to resolving Greece's troubles. German officials agreed to a program under which bondholders would be asked to

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<sup>27</sup> "Greece Timeline". BBC News. 12 March 2012. Web. 20 March 2012. <<http://news.bbc.co.uk/2/hi/europe/1014812.stm>>.

<sup>28</sup> "Greece's 2010 Bailout Falls Flat, Puts Nation Back on Brink of Default a Year Later". Washington Post. 17 June 2011. Web. 15 November 2011. <[http://www.washingtonpost.com/business/economy/greeces-2010-bailout-falls-flat-puts-nation-back-on-brink-of-default-a-year-later/2011/06/17/AGXijSZH\\_story\\_1.html](http://www.washingtonpost.com/business/economy/greeces-2010-bailout-falls-flat-puts-nation-back-on-brink-of-default-a-year-later/2011/06/17/AGXijSZH_story_1.html)>

extend the terms of their existing investments on a voluntary basis, thus decreasing the amount of cash Greece would need to pay off bonds that were coming due”. In addition to this, there was an announcement that “a new cabinet by Prime Minister George Papandreou was also meant to clear the way for a successful vote of confidence in the Greek Parliament, followed by the ratification of further spending cuts and other changes required for Greece to receive about \$17 billion in new emergency loans”.<sup>29</sup>

The situation of course was not what was expected by many, including top IMF officials, to occur and was not the “dynamic economy that will deliver the growth, jobs and prosperity that Greece needs in the future.” Up to this point, no one wanted to think of a possible default, and did not want to believe that Greece was in as bad a situation as it was. Although most of the measures of the bailout did not work, there were a few slight improvements in some aspects of the economy. Greek exports rose, labor costs fell, and inflation was below the European average. “The program met its targets during its first months, and Greek officials even pushed for deeper cuts at the federal level when it turned out local governments had overspent”.

Still, many thought that the bailout could not possibly help the huge problems that Greece faced and that the issues are simply “embedded in the structure of Europe’s economy, political institutions and financial system — and that some analysts reckon may take a decade or more to fix...the Greek program — the largest-ever involving the IMF — was in part meant to buy time to work on underlying issues such as strengthening Europe’s banking system and supporting the weaker European economies”.

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<sup>29</sup> Walsh, Lynn. “New Bailout for Greece Won’t Solve Underlying Debt Crisis — Eurozone: Last-Minute Rescue Package”. Socialist Alternative Org. 1 August 2011. Web. 19 February 2012. <<http://www.socialistalternative.org/news/article12.php?id=1655>>.

## **ii. Results: Failure of First Bailout, Heading into Second**

Although the first bailout made many promises of putting the debt-ridden country back on track, it did little to address and aid in the severity of the economic crisis. Not only did the bailout of 2010 increase the size of the Greeks' debt (burden), but these loans were conditional on very severe austerity measures- they had to tighten their financial belt. Rather than stimulate the economy, which was supposed to be the main purpose of the bailout, it ended up forcing the Greeks to raise taxes, cut spending, and slash wages. This only caused the economy to contract further. The package increased the Greek debts while making it harder for the Greeks to make payments back. As if this wasn't bad enough, Greece still could not afford to fix its problems regarding the troubled economy and its enormous and constantly growing debt. In order to keep the economy going, Greece was forced to borrow more money to keep up with this increasing pile of debt; the problem with this is that it couldn't borrow from traditional markets because no one was willing to lend to them. This can be shown by viewing the interest rates on Greek bonds- the government bond yield for the 10 year notes averaged 5.57 % t reaching an historical high of 37.10 % in March of 2012.<sup>30</sup> The credit rating even reached the world's lowest debt grade, CCC, by Standard and Poor credit rating agency.

The European Union's plan of tax increases, spending cuts, and wage cuts, have all led to one result: a deep recession in Greece. Instead of the economy improving and the recession subsiding, the result has been a deepening of the recession from 2009 when the main economic problems started. The economy shrunk by almost 12 percent between 2009 and 2011 and is expected to shrink by up to 6 percent in 2012. The crisis also "stripped" Greece's political center,

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<sup>30</sup> Greece Government Bond 10Y. Trading Economics. 2012. Web. 20 March 2012. <<http://www.tradingeconomics.com/greece/government-bond-yield>>.

which was already weak, and led to more political instability and various political issues (especially great conflict between political parties and the parties and the Greek people). Unemployment is said to have reached 21 %, although many believe that it is greater than this. In a country whose population is about 11,329,000 (2010)<sup>31</sup> - this is a large amount of people that are unemployed.

There are various social costs, other than financial costs, that have incurred due to the bailout and severe austerity measures. These costs include a large number of businesses closing, scarcity of credit, constant wage cuts that only serve to negatively impact and shrink the already ever-shrinking middle class in Greece. More than half of the money lent to Greece in the 2010 bailout by the International Monetary Fund and European nations went to “repay bondholders, a transfer of billions of dollars from taxpayers around the world to European banks and pension funds that invested in the troubled Mediterranean nation.”<sup>32</sup>

As the country continued to struggle with a collapsing economy, violent strikes and historic levels of unemployment, the bailout didn't seem to promise much to the people, and did more to reassure the holders of the debt that they would get their money back. According to some, “under an initial bailout program approved by the IMF and the European Union in May 2010, Greece's government has been kept afloat by international loans that total \$91 billion”.<sup>33</sup> European banks were among the heaviest investors in Greek bonds and officials in some developing countries have argued that “the IMF, run by a European-dominated board and two consecutive French managing directors, seemed more interested in protecting private investors in

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<sup>31</sup> Population 2010. World Development Indicators database, World Bank, 1 July 2011. Web 10 March 2012. <<http://siteresources.worldbank.org/DATASTATISTICS/Resources/POP.pdf>>.

<sup>32</sup> Schneider, Howard. “Most Greek Bailout Money Has Gone to Pay Off Bondholders”. Washington Post. 22 October 2011. Web. 18 February 2012. <[http://www.washingtonpost.com/business/economy/most-greek-bailout-money-has-gone-to-pay-off-bondholders/2011/10/22/gIQA5V336L\\_story.html](http://www.washingtonpost.com/business/economy/most-greek-bailout-money-has-gone-to-pay-off-bondholders/2011/10/22/gIQA5V336L_story.html)>.

<sup>33</sup> Ibid.

Europe than it did when overseeing programs that wiped out dozens of banks during the Asian financial crisis”.<sup>34</sup>

Although the first bailout was put into effect, Greece’s debts amounted to more than \$300 billion (in outstanding loans). Unlike the new 2012 bailout, the 2010 bailout did not demand that private investors accept losses on their Greek bonds. The argument for this, which was made mostly by officials from the European Central Bank, was that “imposing losses on private investors would wreck the euro region’s credibility and possibly prompt international bond markets to turn on other countries, such as Spain and Italy.”<sup>35</sup>

#### **IV. March 2012 Bailout**

After reviewing and analyzing the first bailout, and why it did not lead to the hoped changes, we can now look at how the second bailout came about.

As the crisis deepened in July of 2011, European Union leaders agreed to a major bailout for Greece over its debt crisis by “channeling 109 billion euros through the European Financial Stability Facility”. Then, all three main credit ratings agencies cut Greece's rating to a level that reflected a substantial risk of default. In September 2011 Moody's downgraded eight Greek banks (due to concerns over Greece's ability to pay back its debts). A month later in October, Eurozone leaders agreed to a 50% debt write-off for Greece “in return for further austerity measures”. George Papandreou cast the deal into doubt by announcing a referendum on the rescue package. In November, faced with a harsh criticism over this plan, Papandreou withdrew

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<sup>34</sup> Schneider, Howard. “Most Greek Bailout Money Has Gone to Pay Off Bondholders”. Washington Post. 22 October 2011. Web. 18 February 2012. <[http://www.washingtonpost.com/business/economy/most-greek-bailout-money-has-gone-to-pay-off-bondholders/2011/10/22/gIQA5V336L\\_story.html](http://www.washingtonpost.com/business/economy/most-greek-bailout-money-has-gone-to-pay-off-bondholders/2011/10/22/gIQA5V336L_story.html)>.

<sup>35</sup> Ibid.

it and it did not go into effect (he soon announced his resignation). In January 2012 the debt rescheduling talks with Greece's private creditors faltered, “endangering the 130bn euro EU/IMF rescue package that Greece needed to meet its next debt repayment deadline in March”.<sup>36</sup> In February violent protests on the streets of Athens continued as, the Greek parliament approved a new package of tough austerity measures agreed with the EU as a 130bn euro bailout. Finally in March Greece reached a "debt swap" deal with its private-sector lenders, enabling it to halve its massive debt-load or get a 50% haircut.<sup>37</sup>

A government of “national unity formed” after talks between leaders of the governing Socialist PASOK, the center right New Democracy party and the nationalist Laos party. Then, Lucas Papademos, a former head of the Bank of Greece, became interim prime minister with the task of “getting the country back on track in time for elections scheduled provisionally for the spring of 2012”. On March 13<sup>th</sup>, 2012, Eurozone finance ministers signed a second Greek bailout package, worth €130 billion. Greece slashed its debts by more than €100bn by “swapping its privately held bonds for new, longer maturity paper with less than half the nominal value”.<sup>38</sup> As a result of this bond swap offer, Greece's debt was expected to fall below a target of 120% of GDP in 2020, reaching 117%, from 160%.

Economic affairs commissioner Olli Rehn stated that “the success of the Greek programme would hinge on implementation risks and political unity in Greece”, as the elections are on April 15<sup>th</sup> and the two main parties are having difficulty with the polls. Meanwhile, lawyers in Germany representing 110 Greek bondholders launched a class action suit to sue

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<sup>36</sup> “Greece Timeline”. BBC News. 12 March 2012. Web. 20 March 2012.

<<http://news.bbc.co.uk/2/hi/europe/1014812.stm>>.

<sup>37</sup> Ibid.

<sup>38</sup> Kollewe, Julia. “Greece Bailout Package Signed Off by EU Leaders”. The Guardian. 12 March 2012. Web. 20 February 2012. <<http://www.guardian.co.uk/business/2012/mar/13/greece-bailout-package-signed-off>>.



banks and the Greek state. EU finance ministers had insisted that the debt swap deal was a condition that had to be met before they would agree to sign off the 130 billion euro bailout. There were news that Greece may expect a recession much worse than the official forecast, with the contraction expected at 5% or more in 2012. The Foundation for Economic and Industrial Research, also known as IOBE, also foresaw contraction and even the IMF expected a gross domestic product contraction of 4.8%.<sup>39</sup>

The report also projected unemployment rising even more to 20% this year (up from a 17.3% percent in 2011 and inflation to fall from levels below 1% from 3.1% last year as demand weakens. Greece completed most of the planned 206 billion euro debt restructuring plan, which was part of the 130 billion euro bailout. Greece's government is aiming "to pass the final pieces of legislation--that are a precondition for the new bailout--by April and pave the way for national elections thereafter". The new government will have to announce about 11 billion euros in further austerity measures by June to cover expected budget gaps in 2013 and 2014.<sup>40</sup>

## **V. Case studies: Countries with Similar Situations**

### **i. Argentina's Financial Crisis**

After discussing the economic woes and troubles in Greece which led to the need for a bailout, similar cases can be addressed to possibly bring some light on what Greece can do to aid in economic recovery. A country that faced very similar economic problems and managed to recover and get back on track was Argentina.

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<sup>39</sup> "Greece Timeline". BBC News. 12 March 2012. Web. 20 March 2012. <<http://news.bbc.co.uk/2/hi/europe/1014812.stm>>.

<sup>40</sup> "Greek Economy To Shrink At Least 5% In 2012, Says Think Tank". Wall Street Journal. 2 April 2012. Web. 3 April 2012. <<http://online.wsj.com/article/BT-CO-20120402-707800.html>>.

Argentina's crisis started in the mid-1990s and worsened over the years, eventually reaching full recession from 1999-2002. In December 2001 the Argentine government declared that it could no longer pay back its debts and went into default. At US\$ 93 billion, Argentina's default falloff became the largest sovereign default in history.

Argentina accumulated unpayable debt because loans were unwisely taken and even more unwisely offered- something that is very Greece's crisis situation. In 2005 Argentina's Finance Minister Roberto Lavagna announced the government's decision to restructure \$88 billion in defaulted debt with a 75% "haircut". Lavagna's response was that the country wouldn't repeat past mistakes: "...when the government ignored its own limited ability to pay in order to secure rapid bondholder acceptance."<sup>41</sup> As the country faced excessive debt, a deep recession, and also bank run (as people worried about the safety of their money and savings in Argentinian banks), Argentina declared default on \$132 billion in debt. The country also abandoned its fixed exchange rate with the dollar, which led to the value of the Argentine peso falling to extreme levels.<sup>42</sup>

At this point, Argentina did what most countries would do in this situation to promote growth and competitiveness- it devalued its currency; the country also defaulted on over 65% of total public debt. Along with enjoying an economic boom to its utilization of its rich natural resources, all these measures contributed to a period of unprecedented growth. In 2011 the

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<sup>41</sup> Chelala, Cesar. "What Greece Can Learn from Argentina". The Epoch Times. 9 March 2012. Web. 20 March 2012. <<http://www.theepochtimes.com/n2/opinion/what-greece-can-learn-from-argentina-201703.html>>.

<sup>42</sup> Ibid.

country continued enjoying years of constant growth led by its cheapened exports- its GDP rose to 9.2% in 2010.<sup>43</sup>

The Argentine economic crisis unleashed widespread social protests and unseated five presidents within a year, taking the country several years to recover. One of the main causes of the crisis, however, remains largely ignored. As Mark Weisbrot, co-director of the Center for Economic and Policy Research (CEPR) in Washington, DC, stated last October, “Argentina recovered quickly because it freed itself not only from an unsustainable debt burden, but also from the destructive policies imposed by creditors and their allies.”

## **ii. Comparison to Argentina: Greece's Financial Crisis as a Reflection of Argentina's Crisis**

As we have seen, there are many similarities between the current Greek debt crisis and the Argentinian debt crisis in 2001. The economic regimes that led to the recession in both countries appear similar. In the “context of economic deregulation and financial and commercial liberalization, Argentina’s “convertibilidad” policy, which pegged the Argentine peso to the dollar, and the adoption of the euro in Greece, established a fixed and overvalued exchange rate regime. This helped to control inflation but with the cost of deteriorating local productive capacity”.<sup>44</sup> In addition to this, in both cases the stability of the economy became “dependent on capital inflows to stimulate domestic demand. But due to permanent balance of payment deficits, the economies became dependent on foreign debt. Therefore, the trigger of the crises in both

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<sup>43</sup> “Argentine Economy Expanded 9.2% in 2010 and Begins 2011 with a”6% floor”. MercoPress. 19 March 2011. Web. 20 March 2012. < <http://en.mercopress.com/2011/03/19/argentine-economy-expanded-9.2-in-2010-and-begins-2011-with-a-6-floor>>.

<sup>44</sup> Nemina, Pablo. “IMF from Argentina to Greece: Similar but Different”. Bretton Woods Project. 7 February 2012. Web. 20 February 2012. < <http://www.brettonwoodsproject.org/art-569567>>.

cases comes from the limited external financing rather than fiscal deficits”.<sup>45</sup>

Something important to note is that the Argentine capital account worsened with the 1998 Asian financial crisis and Greek one with the 2008 crisis, and in both cases fiscal austerity and wage cuts were called for by creditors. In Argentina, despite the context of a recession, the IMF encouraged the implementation measures such as the reduction of social spending and the loosening of labor protection. In Greece the IMF-European Union-European Central Bank also imposed unpopular adjustments like the ones in Argentina to make sure the monetary regime continued and the financial sector profits were protected.<sup>46</sup>

Greece is not using its own currency, but a transnational one which is the Euro, while Argentina pegged its currency to the U.S. dollar. A connection to a greater currency allows only limited policy responses and prevents the usual money printing that would have taken place when debt becomes too high. This in turn causes a gradual rise in inflation up to the point of hyperinflation (Greece and Argentina have both experienced hyperinflation in the past). While skyrocketing interest rates in Greece are implying there is massive inflation, the official inflation rate is under 3%. Yields on one-year Greek governments reached approximately 100%, which implied something other than inflation due to a falling currency- the euro in this case.

Inflation is caused by a falling currency and hyperinflation by a collapsing currency. Since the euro did not drop that much and Greece uses the euro, inflation didn't seem to occur in Greece. Argentina tying its currency to the dollar also created a very low inflation rate as long as

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<sup>45</sup> Nemina, Pablo. “IMF from Argentina to Greece: Similar but Different”. Bretton Woods Project. 7 February 2012. Web. 20 February 2012. < <http://www.brettonwoodsproject.org/art-569567>>.

<sup>46</sup> Ibid.

the peg lasted. Extravagant and somewhat wasteful government spending usually ends up leading to major inflation. The inflation only showed up in Argentina after it separated its currency from the U.S. dollar and will probably show up Greece after it detaches itself from the euro. Instead of gradually building inflation, sudden major inflation will take place, such as was shown in the Argentina case. Argentina accumulated an unpayable debt because loans were recklessly taken and offered, a situation very similar to Greece's.

The Argentinian crisis began when a new government was elected in December 1999 and had to deal with years of mismanagement from the previous administration. Like Argentina, Greece elected a new government in October 2009 and shortly thereafter it revealed that it had a lot more debt and higher budget deficits than it had claimed. In both cases, sharp spending cuts were implemented and riots followed. By December 2000, Argentina had acquired bailout funding from the International Monetary Fund. Like Argentina, Greece received its first bailout in 2010 from the EU and the IMF, and at this point financial reports, experts, and people thought that everything would work out in the best interests of Greece and its economy. In the spring of 2001, the major events of the financial crisis occurred and spiraled down in Argentina. Similarly, in the spring of 2011, events spiraled down in Greece. In August 2001, Argentina received an increase in its "standby loan" from the IMF. Again, Greece received hope and hinted of a possible second bailout, which it did receive in March 2012. Argentina engaged in debt swaps in June and November of 2001. Interest payments on Argentina's debt eventually overwhelmed rescue attempts and on December 5, 2001, the IMF announced it would not disburse promised aid to Argentina. A collapse followed shortly thereafter. In December 2001, to avoid wider and more punishing social unrest, the Argentine government declared that it could no longer fully pay back its debts and the country went into default. The conclusion: the countries are extremely

similar regarding their crises, but the solution as of yet is different, as Argentina defaulted and Greece accepted a second bailout in 2012.

To get a better look at where Greece and Argentina stood before and after their crises, the following graphs depict various factors for comparison, including foreign direct investment, government bond yields, unemployment, and GDP. There are similar trends in both countries regarding many of these factors, as can be shown below.



(World Bank Group)

Figure 3: Greece Foreign Direct Investment; net (BoP; US dollar) 2004-2010



(World Bank Group)

Figure 4: Argentina Foreign Direct Investment; net (BoP; US dollar) 1994-2004

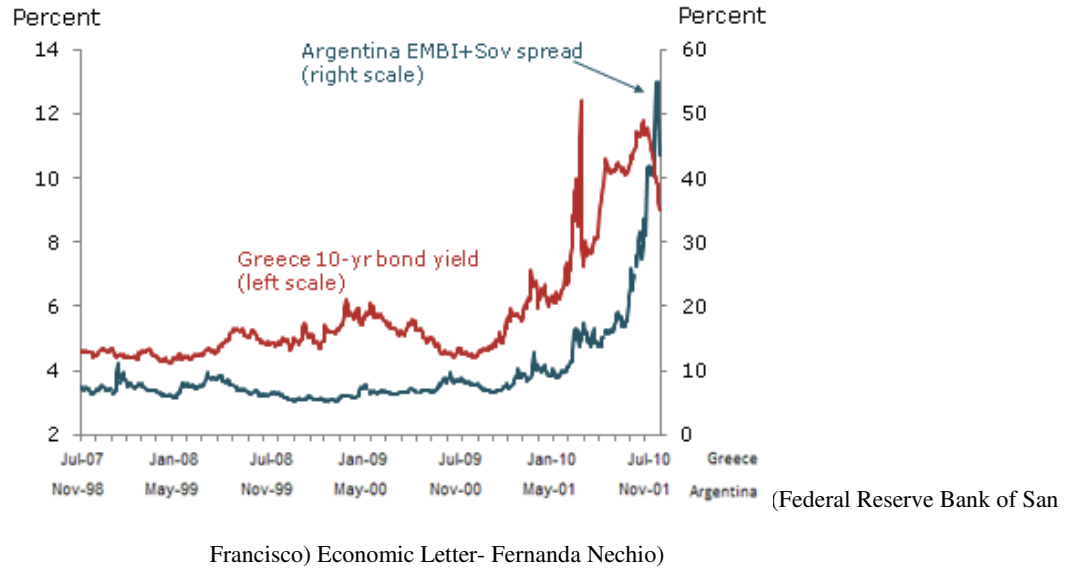


Figure 5: Comparison of Greece and Argentina Government Yields Before-During Crises

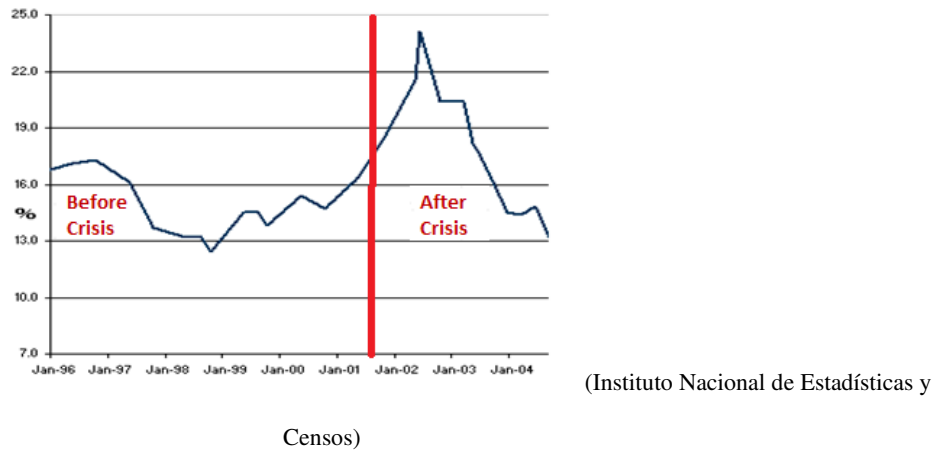


Figure 6: Argentina Unemployment 1996-2004

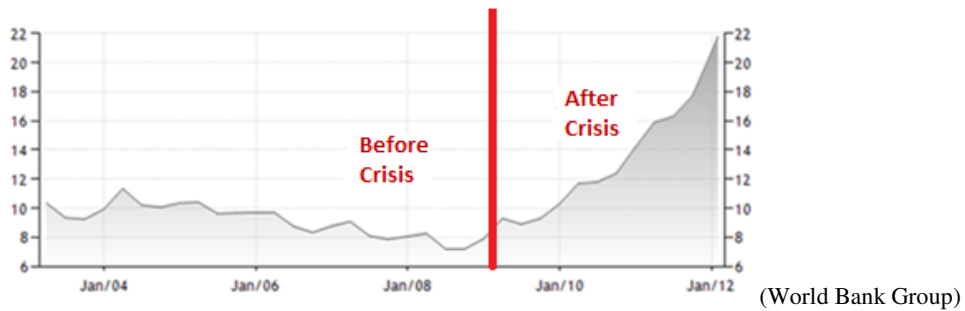
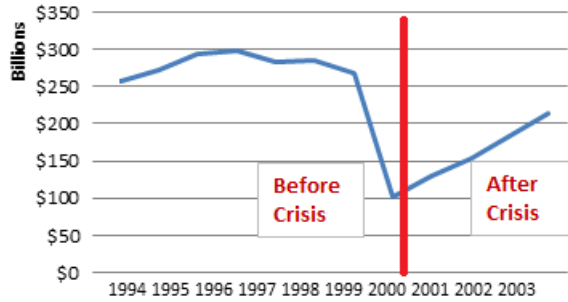
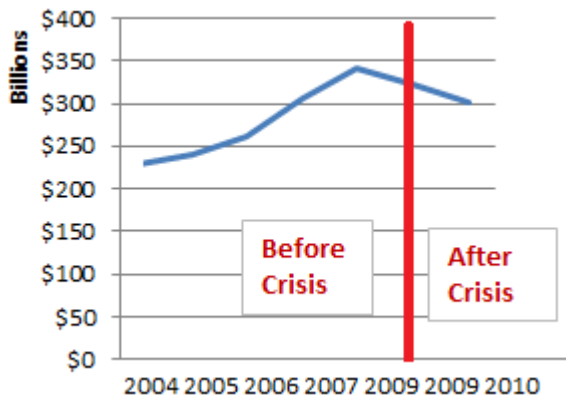


Figure 7: Greece Unemployment 2004-2012



(World Bank Group)

Figure 8: Argentina GDP 1994-2003



(World Bank Group)

Figure 9: Greece GDP 2004-2010

**Table 1**  
Comparing Greece (2009) to Argentina (2001)

	Greece (%)	Argentina (%)
Deficit/GDP	12.9	6.3
Debt/GDP	115.1	62.2
Primary deficit/GDP	8.5	1.4
Current account deficit/GDP	11.2	2
Exports/GDP	10	8
Debt/GDP held abroad	75	60

(Federal Reserve Bank of San Francisco: Economic Letter-

Fernanda Nechio)

Figure 10: Comparing Greece (2009) to Argentina (2001)



❖ *As these graphs show, the GDP was lower in the years leading up to each country's crisis, and for Argentina, it was higher after the worst of the crisis ended (and they defaulted) but soon picked up. Unemployment and foreign direct investment were also lower after both crises, and government bond yields have an extremely similar pattern in both countries before, during, and after the crises.*

### **iii. Lessons from Argentina- Proposed and Similar Measures**

After viewing the Argentinian crisis and the measures and steps taken to restore a healthier economy, there are many things Greece can learn from. The restructuring of an unpayable debt and improving competitiveness to the economy are key elements for the restoration of production and employment creation.<sup>47</sup> Although the crises in both countries are similar and bear they have comparable trends in both crises, Greece's situation is much worse.

Still, the case of Argentina can be used to teach a lesson and possibly provide some solutions to what can be done to promote growth and a positive road to recovery. It may be more difficult for the Greeks than it was for the Argentines to overcome this difficult situation. Argentina's recovery benefitted largely by the increase in international prices of some key agricultural products and a rise in exports of natural resources, as the demand for these products continued to increase from foreign countries. Unfortunately for Greece this is not the case, as Greece depends on its service economy of tourism and shipping and not so much on the export of resources. Still, Greece can take the example of the restructuring of debt that Argentina pursued (a factor in the 2012 bailout). Of course this is difficult because Greece still remains in

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<sup>47</sup> Nemina, Pablo. "IMF from Argentina to Greece: Similar but Different". Bretton Woods Project. 7 February 2012. Web. 20 February 2012. < <http://www.brettonwoodsproject.org/art-569567>>.

the Eurozone and has not abandoned the euro as Argentina dropped the peg with the dollar and went back to the peso. Although the currency conversion hurt the economy temporarily, it was able to slowly get the economy back on track and become competitive in the international markets (as exports dramatically increased due to the devaluation of the peso and an increase in worldwide commodity prices).

If Greece defaulted, it would have to produce a new currency or adopt its previous one, the drachma, which will not be easy as it will have to wait for it to stabilize, just as Argentina did with the peso. As the value would hurt anyone holding the currency, depositors would try to move their money to banks elsewhere in the Eurozone before any currency conversion could be enforced. In Argentina, “unable to provide the U.S. dollars needed to back bank deposits, the government announced an end to the currency peg, causing many Argentines to lose large portions of their savings. Left to float freely on the market, the peso eventually fell about two thirds in value, while GDP plunged 11% in 2002 and unemployment hit 25%”.<sup>48</sup> This could happen in Greece if this currency change occurred, and would also keep new money from flowing in, such as direct or indirect investment, which plays a large role in the economy.

Argentina also escaped its enormous debts by refusing to pay them back in the full amount owed; four years after this they agreed to pay only a partial amount of the money owed, which led to a very steep loss for creditors. If Greece defaults, the Greek banks, the largest holders of Greek government debt would likely collapse. On the other hand, the government could actually have an easier time than Argentina in re-negotiating its debts and converting them

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<sup>48</sup> O’Toole, James. “Greek debt crisis: Shades of Argentina”. CNN Money. 8 November 2011. Web. 28 March 2012. <[http://money.cnn.com/2011/11/08/news/international/greece\\_euro\\_argentina/index.htm](http://money.cnn.com/2011/11/08/news/international/greece_euro_argentina/index.htm)>.

to a new currency; "Most of the Greek bonds were issued under Greek law, so they can just change it, whereas Argentina had issued bonds in New York and London".<sup>49</sup>

Of course, if Greece does default and exit the Euro, the problems would spread throughout Europe and financial markets. "First, a return to a Greek currency depreciated against the euro will face opposition from Germany, as it will affect its export-led growth strategy. Greece's limited productive capacity also hinders the likelihood of finding alternative international trade beyond the European Union (EU). Second, the Greek debt is concentrated in French, German and British banks. These countries are less likely to promote a debt restructuring large enough to restore the solvency of the Greek government. Argentina, however, had its debt distributed in various individual and institutional creditors (almost 40 per cent local, which facilitated the negotiation), and its aggressive renegotiation strategy was supported by the US, which sought to reduce moral hazard in international capital markets by making an example of Argentina. Also, in 2001 the world economy was on the verge of a period of robust growth, but it is now mired in a deep international crisis. Third, IMF intervention in Greece is done with the EU and the European Central Bank (ECB), who are leading the process. Therefore, its role is limited to providing loans attached to the EU and ECB conditionality package of fiscal austerity and privatisation. In the Argentine case, the main global powers left the IMF in charge alone."<sup>50</sup>

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<sup>49</sup> O'Toole, James. "Greek debt crisis: Shades of Argentina". CNN Money. 8 November 2011. Web. 28 March 2012. <[http://money.cnn.com/2011/11/08/news/international/greece\\_euro\\_argentina/index.htm](http://money.cnn.com/2011/11/08/news/international/greece_euro_argentina/index.htm)>.

<sup>50</sup> Nemina, Pablo. "IMF from Argentina to Greece: Similar but Different". Bretton Woods Project. 7 February 2012. Web. 20 February 2012. <<http://www.brettonwoodsproject.org/art-569567>>.

#### **iv. Eurozone neighbors: Portugal, Spain, Ireland**

Although Ireland has been compared to Greece regarding the financial crises both countries' experience, there are some notable differences. Ireland entered its recession in a very different situation to that of Greece. It experienced an economic boom in the 1990s, as large multinational companies rushed to invest and operate (due to a low corporation tax and a well-educated workforce). This in turn led to low unemployment rate and Ireland even started seeing large numbers of immigrants coming to look for work. Inflation started rising and became widespread, and simultaneously there was a property bubble that seemed to be ready to explode at any moment.

Similarly to Ireland, Spain's property and construction industry created a bubble which once the world economic slump struck. Once these global factors struck Greece, its economy was exposed. The problems caused by the global recession were made worse when it was revealed that national statistics had been altered in order to cover the fact that Greece's debt levels exceeded limits set down by the EU.<sup>51</sup>

Due to this inflated amount of debt level, the economic crisis was more distinct in Greece than either Spain or Ireland, and this led to EU and IMF intervention and the passing of the bailout in 2010 of €110 billion. The key difference between the bank bailouts in Ireland and Spain compared to that of Greece is that "the former two were in a position to undertake the bailout themselves and, up to now at least, have not required IMF intervention. The governments of Spain and Ireland have been in a position to take over national banks, guarantee savings and

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<sup>51</sup> Mitchell, Brian. "Case Studies in Crises: Ireland, Spain and Greece". The Beginner. 23 August 2010. Web. 29 March 2012. < <http://www.thebeginner.eu/economy/all-in-finance/290-case-studies-in-crises-ireland-spain-and-greece>>.

make efforts to stabilize the banking sector. These efforts, on the whole, have met with approval from the EU and the IMF who are monitoring events closely to ensure the Greek situation is not replicated. This is a particular concern for Spain whose economy is far larger than Greece's and is one of the biggest in the EU".<sup>52</sup>

Although the economic crisis in these three countries has different origins and different types of action taken, there are some similarities. For example, the governments of each of the countries have taken similar actions regarding public sector pay where wages have been reduced or frozen, and pensions diminished. In Spain, just as in Greece, protests occurred once measures were taken, although they were notably more violent ones in Greece.

Still, since these countries mentioned are all part of the Eurozone their crises not only affect them as individual entities, but parts of a large (and very influential one- one that affects the world economy). In order to keep the strength of the Euro, the shared Eurozone currency, and make sure it does not become devalued (which can lead to severe consequences), these issues involve everyone in the Eurozone and this is why help has been given up to this point. The EU and IMF monitored and advised policies and courses of action in Spain and Ireland, and have provided bailouts and much-needed funding to Greece.

While Spain and Ireland share similarities in their experience of their own economic crises, Greece's fundamentally more severe experience serves as an economic warning to all EU countries. It is necessary that these countries have to stick together.

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<sup>52</sup> Mitchell, Brian. "Case Studies in Crises: Ireland, Spain and Greece". The Beginner. 23 August 2010. Web. 29 March 2012. < <http://www.thebeginner.eu/economy/all-in-finance/290-case-studies-in-crises-ireland-spain-and-greece>>.

When discussing these countries and their economic crises, we must look at their causes in relation to the Eurozone and its structure. The crisis started because debt in the Eurozone's peripheral countries, or as the nickname and abbreviation, "PIGS" was used: Portugal, Ireland, Greece, and Spain, became so large that investors grew frightened that entire countries were at risk of default. An element that of the structure of the Eurozone that many might miss is that the design of common currency "not only caused, but was meant to cause the Eurozone's periphery to incur large amounts of international debt. Further, there was little that the governments of those countries could do to stop it. Far from causing the crisis, the peripheral Eurozone countries were up against powerful forces outside their control, forces that probably made this crisis inevitable no matter how responsibly they behaved".<sup>53</sup> When you make a union of countries with strong economies and ones with weaker ones, there is no doubt that this will lead to many problems that might have been avoided if they did not join. For example, if a country stands alone and has its own currency, if the economy is doing poorly, they can devalue their currency to increase competitiveness, and use measures that might have worked previously without intervention of outsiders; clearly not the case with a union and a joint common currency. One of the goals of Europe's common currency has been to "promote greater financial market integration between member countries and was hoped that the common currency would make it easier for investors in one euro country to find good investment opportunities in other euro countries because they would no longer have to worry about fickle exchange rates".<sup>54</sup> Put more simply, it would be easier for capital to flow from countries with plentiful capital which would mean lower returns to investments, to countries that did not possess these abundant amounts of

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<sup>53</sup> Mansori, Kash. "Why Greece, Spain, and Ireland Aren't to Blame for Europe's Woes". The New Republic. 11 October 2011. Web. 14 December 2011. <<http://www.tnr.com/article/economy/95989/eurozone-crisis-debt-dont-blame-greece>>.

<sup>54</sup> Ibid.

capital and therefore offered higher returns on investments. This is considered a “crucial ingredient in the process of economic convergence, in which less developed countries catch up with the more developed”.

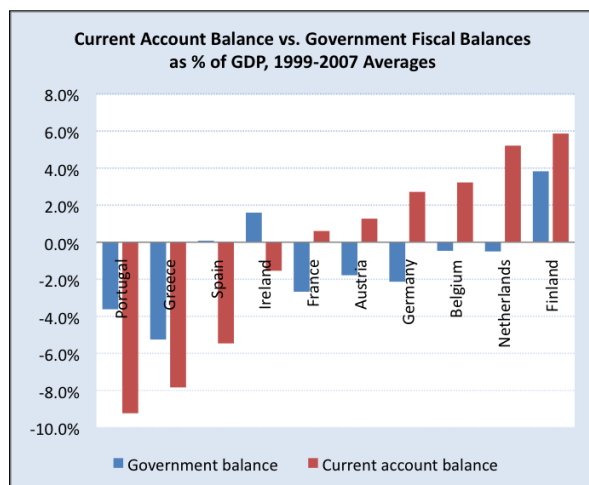
Capital-rich countries were at the core of the Eurozone; these included Germany, France, the Benelux countries, Austria, and Finland. The adoption of the euro by the periphery countries in 1999 allowed lenders in the Eurozone’s core to take advantage of relatively high rates of return in the periphery, and the periphery countries, in turn, were able to benefit from the influx of capital that reduced borrowing costs. The adoption of the euro as a common currency was designed to cause large capital flows from the Eurozone core to the periphery (it is these very capital flows that partly set off the crisis). The current account deficits of the periphery countries grew enormously in the years following euro adoption in 1999, while the core countries became substantial sources of capital outflows.<sup>55</sup> Investors in the core seemed satisfied with the relatively high returns they were getting in the periphery, and simultaneously the periphery countries enjoyed boost in their economy which was funded partly by the now easy access to the large amounts of capital. This all soon came to a halt by 2004, when there was almost no difference in interest rates of the periphery countries and that of Germany, one of the strongest of the core countries.

The periphery of the Eurozone bore most of the systemic risks inherent to the common currency area, while the benefits were shared by both the core and the periphery, although the “burden of solving the crisis has been placed so overwhelmingly on the periphery countries

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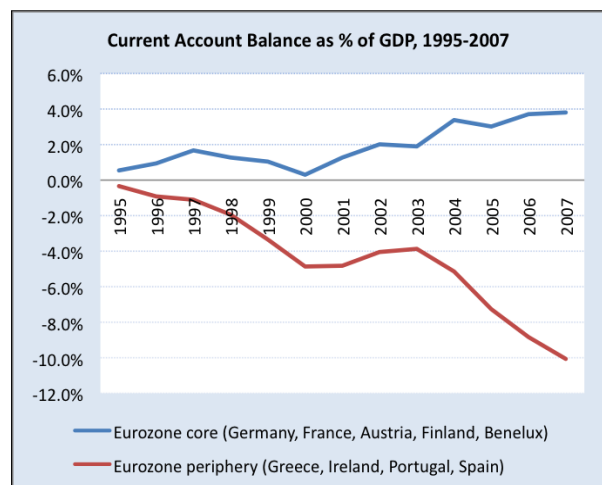
<sup>55</sup> Mansori, Kash. “Why Greece, Spain, and Ireland Aren’t to Blame for Europe’s Woes”. The New Republic. 11 October 2011. Web. 14 December 2011. <<http://www.tnr.com/article/economy/95989/eurozone-crisis-debt-dont-blame-greece>>.

through the debilitating austerity measures demanded by the core countries”.<sup>56</sup> The core Eurozone countries like France and Germany reaped the benefits when it setting up the structure of this system, and enjoyed the common currency. The peripheral countries were exposed to risks and inequalities, along with unfair disadvantages regarding competitiveness. All these led to the crises that occurred, but none as bad as Greece. The comparison of the current accounts and the differences in the core countries’ and the periphery countries’ can be seen in the below graphs. The following graphs show how large the difference was regarding the current account balances of the core and periphery countries of the Eurozone.



(The New Republic)

Figure 11: Current Account Balance vs. Government Fiscal Balances of as % of GDP, 1999-2007 Averages, Eurozone Members



(The New Republic)

Figure 12: Current Account Balance Balances as % of GDP, 1995-2007 Averages, Eurozone Members

## v. Mexico

Another similar situation to that of Greece (and of the countries mentioned above) involves a country outside of Europe: Mexico. The crisis occurred in Mexico after the creation

<sup>56</sup> Mansori, Kash. “Why Greece, Spain, and Ireland Aren’t to Blame for Europe’s Woes”. The New Republic. 11 October 2011. Web. 14 December 2011. <<http://www.tnr.com/article/economy/95989/eurozone-crisis-debt-dont-blame-greece>>.



of NAFTA in the early 1990s, and East Asia in the mid-to-late 1990s. When the less developed countries became more integrated with the rest of the world, investors typically tried to take advantage of this by putting capital and investing in them. Since the actions taken in these situations are usually followed with swarms of investors using the same mindset, they usually follow the same patterns and this behavior could suddenly stop if investor feelings and attitudes change. This usually signals a start to financial crises-very severe ones. And when that happens, severe financial crises often follow. “Capital flow “bonanzas” significantly raise the risk of financial crises; in fact, they find that such episodes systematically precede sovereign debt crises, because once the capital flow stops, the country on the receiving end is suddenly unable to roll over the debt it has accumulated- it’s not speed that kills, it’s the sudden stop”.<sup>57</sup>

Sudden halts of the cash flow may happen even when a country seems to be following and enacting policies that seem appropriate. The Mexican and East Asian financial crises of the 1990s serve to show this, and in the case of the Eurozone, the “sudden stop to capital flows in 2009 indiscriminately hit all of the periphery countries, regardless of how well they had managed their finances”.<sup>58</sup> Spain and Ireland, for example, were more financially responsible during the boom years than France or Germany, yet that wasn’t enough to inoculate them from the sudden end to the capital flow bonanza. So even if Greece and Portugal (which, like Greece, ran large budget deficits) had been models of financial responsibility, it still was quite likely that they would still have been hit by the sudden stop to the capital flow influx. That’s why the best

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<sup>57</sup> Mansori, Kash. “Why Greece, Spain, and Ireland Aren’t to Blame for Europe’s Woes”. The New Republic. 11 October 2011. Web. 14 December 2011. <<http://www.tnr.com/article/economy/95989/eurozone-crisis-debt-dont-blame-greece>>.

<sup>58</sup> Ibid.

predictor of which countries were hit by this crisis was “not budget deficits, but rather the size of the capital flows they were receiving”.<sup>59</sup>

These examples of other countries’ crises, along with Greece, show that it is various factors, and not just the behavior or irresponsible actions of the people. The common joint currency played a very large role in creating crisis, and not only the irresponsible behavior of the countries faced with the crisis in the Eurozone.

## **VI. Odious debt- Introduction of Concept**

As the second bailout package came about, many wondered how the large debt-load would be repaid, even if some creditors would have to incur losses. Some even proposed that Greece should not have to necessarily pay back many of its debts, which were incurred through uncontrolled and irresponsible government spending. This all ties in with the following concept of odious debt.

An extreme example of a country dealing with debt, and even ridding itself of it almost completely, will now be discussed. In the past, dozens of countries have successfully repudiated debts not incurred by their citizens, in accordance with provisions of the international law, such as the concept of odious debt which was coined by Alexander Sack in 1927. Sack went on to say that creditors who lend to dictators "have committed a hostile act against the people" and cannot expect a nation that has overthrown a despot to "assume ... the personal debts of the ruler." Although this definition is widely accepted, there is no “formalized international legal structure

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<sup>59</sup> Mansori, Kash. “Why Greece, Spain, and Ireland Aren’t to Blame for Europe’s Woes”. The New Republic. 11 October 2011. Web. 14 December 2011. <<http://www.tnr.com/article/economy/95989/eurozone-crisis-debt-dont-blame-greece>>.

for either determining which debts are odious or enforcing the forgiveness of such debts”.<sup>60</sup> In order for debt to be odious there have to be three prerequisites- the government of the country receives loans without the knowledge and approval of the people, the loan is spent on activities is not beneficial to the people, and the lenders know of this situation.<sup>61</sup>

### **i. Cases Involving Odious Debt**

This concept was applied to Iraq under the rule of Saddam Hussein and helped release the country from its debts.<sup>62</sup> On December 17, 2004, the United States completely forgave \$4.1 billion — 100% of Iraqi debt to the United States.<sup>63</sup> In addition to the U.S., various other creditors will probably be forgiving extremely large amounts of money owed. The U.S. wanted to prove that Iraq debt is odious, but didn't want to use this concept officially because other countries may claim the right as well.

The concept of odious debt has been seen in other countries, such as in 1883 in Mexico, which “repudiated debts incurred by the Austrian Hapsburg Emperor Maximilian to prop up his reign over Mexico between 1863 and 1867 and suppress an uprising there”. Also, in 1898, the United States pushed to wipe out debts Cuba owed Spain, on the terms that “the debts prevented the Cuban people from rebelling against Spanish colonial rule”. In 1923, the Costa Rican government distanced itself from money lent by Great Britain to Federico Tinoco, the dictator in Costa Rica from 1917-1919. Lastly, the states of the former Yugoslavia are “currently in

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<sup>60</sup> Pan, Esther. “IRAQ: The Regime’s Debt”. Council on Foreign Relations. 31 December 2003. Web. 23 March 2012. < <http://www.cfr.org/iraq/iraq-regimes-debt/p7796#p25>>.

<sup>61</sup> Graeme, Smith. “A New Euro Crisis Strategy: Deny the Debt”. The Globe and Mail. 20 November 2011.

<sup>62</sup> Damele, Jai. “The Odious Debt Doctrine After Iraq”. Duke University. 2007. Web. 1 April 2012. <<http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=1443&context=lcp>>.

<sup>63</sup> Weiss, Martin. A. “Iraq: Paris Club Debt Relief”. Congressional Research Service. 19 January 2005. Web. 2 April 2012. < <http://fpc.state.gov/documents/organization/44019.pdf>>.

negotiations to avoid paying back funds lent to Yugoslavia to finance military action against its breakaway republics”.<sup>64</sup>

Another example of viewing debt as illegitimate and unconstitutional is Ecuador. During the period of 1980-1990 up to 2005, almost 50% of the government budget was used to repay debts. At about \$3-4 billion dollars a year, only 4% was used for healthcare- \$4 billion for repaying debts and \$400 million for healthcare. President Correa declared it unnatural to use oil revenues to pay back national debt and suggested that most revenues should be used for health benefits, education, and for the creation of jobs. The president stated that some of Ecuador's \$10 billion debt was contracted illegally by a previous administration. The country's default marked the first in Latin America since 2001 (Argentina). He vowed to use spending on public programs first and foremost, before any foreign debt repayment.<sup>65</sup> The government has increased healthcare, education, new jobs, and infrastructure since this occurred.

## **ii. Possible Application to Greek Debt**

Now we are left to wonder, can the case of odious debt be used for Greece? The debt of Greece shows illegitimate in many cases through various examples, both uncovered to the public, and many more that remain unknown. Authorities received gifts from companies (such as Siemens) and bribed ministers and officials for at least a decade to gain contracts. A former Greek transport minister was also charged with money laundering after he told the inquiry that

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<sup>64</sup> Pan, Esther. "IRAQ: The Regime's Debt". Council on Foreign Relations. 31 December 2003. Web. 23 March 2012. < <http://www.cfr.org/iraq/iraq-regimes-debt/p7796#p25>>.

<sup>65</sup> "Ecuador Defaults on Foreign Debt." BBC News. 13 December 2008. Web. 16 March 2012. < <http://news.bbc.co.uk/2/hi/7780984.stm>>.

he had received more than \$123,000 from Siemens in 1998 as a campaign donation.<sup>66</sup> Debt is illegal and illegitimate as proven in these cases. The Greek political elite showed they could reward allies.<sup>67</sup>

Goldman Sachs was blamed for helping conceal the real state of the country's finances, and also was accused of eventually betting against its sovereign debt, along with other major banks. In February 2010 it was said that Goldman Sachs had "devised a derivatives deal that legally circumvented the Maastricht rule. In other words, it masked the extent of the government deficit." Around 2002 in particular various investment banks offered complex financial products with which governments could push part of their liabilities into the future. Among those who accepted were Greece's debt managers, who agreed a huge deal with Goldman Sachs at the start of 2002. The deal involved "cross-currency swaps" in which government debt was swapped for euro debt for a certain period to be exchanged back into the original currencies at a later date.

Although the transaction is not uncommon and has the features of common futures that are traded regularly, the difference was that the US bankers "devised a special kind of swap with fictional exchange rates...this enabled Greece to receive a far higher sum than the actual euro market value of \$10bn or yen. In that way Goldman Sachs secretly arranged additional credit of up to \$1 billion for the Greeks. This credit disguised as a swap didn't show up in the Greek debt statistics." As a result, in 2002 the Greek deficit was calculated at only 1.2 % of GDP, although as Eurostat claimed was really at 3.7%. The country's 2009 deficit was again revised up from 3.7

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<sup>66</sup> Gatopoulos, Derek. "Greek Financial Crisis: Did 2004 Athens Olympics Spark Problems In Greece?". Huffington Post. 3 June 2010. Web. 17 December 2012. < [http://www.huffingtonpost.com/2010/06/03/greek-financial-crisis-olympics\\_n\\_598829.html](http://www.huffingtonpost.com/2010/06/03/greek-financial-crisis-olympics_n_598829.html)>.

<sup>67</sup> *Debtocracy*. Dir. Katerina Kitidi, Aris Chatzistefanou. The Press Project. 6 April 2011. Movie.

% of GDP to 12.7 %, and finally to 13.6% after Greek sovereign debt was downgraded to junk status.<sup>68</sup>

Another case to be made is the one involving the sale of weapons to Germany. Germany stated that it would support Greece with one of the main terms being that Greece would continue to import German arms- Greece should basically cut down on pensions and social benefits, not on arms' imports. Germany protected the interest of military equipment manufacturers, continue trading despite crisis. France and Germany sell equipment (helicopters, submarines, and arms) but lend to Greece to purchase it.

Many have even blamed Germany and France for “encouraging and benefiting from some of the much-criticized profligate spending that reduced Greece to near bankruptcy”. The arms purchases were beyond Greece's capacity to absorb, even before the financial crisis struck in 2009... even in 2010, when the extent of the financial disaster was apparent, Greece purchased these weapons and machinery although it was obvious it could not afford them, as the crisis deepened with overspending.<sup>69</sup>

Lastly, a case can be made regarding the large amounts spent for the 2004 Olympic Games that many thought were unnecessary and could have been used for other much needed

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<sup>68</sup> “Goldman Sachs’ role in Greece a real scandal”. Independent Online Business Report. 19 March 2012. Web. 27 March 2012. <<http://www.iol.co.za/business/business-news/goldman-sachs-role-in-greece-a-real-scandal-1.1258930>>.

<sup>69</sup> Cockburn, Patrick. “France and Germany To Blame for Greece Crisis”. The Independent. 20 February 2012. Web. 22 March 2012. <<http://www.independent.co.uk/news/world/europe/france-and-germany-to-blame-for-greece-crisis-7218923.html>>.

social programs that would benefit society and not result in sinking the country further in unnecessary debt (the money came from Greek taxpayers).<sup>70</sup>

To conclude, part of Greece's national debts can be considered illegitimate because they resulted from policies against people's interests. There are also cases where officials have taken money from loans and government funds for personal use, and possibly "hid" it in offshore bank accounts. This cannot be physically proven though, unless deep investigation of these practices occurs. Greece cannot pay back that debt, even if proved to be legitimate. If honoring the debt and making it sustainable involves dismantling education, healthcare, transport system, then the debt is socially unsustainable. A very large amount of the debt was accrued because of corruption in the financial markets, and people shouldn't have to pay this debt. It is clearly immoral to pay immoral debt.

## **VII. Greece's Economic Options Weighted**

### **i. The Current Situation**

To draw into the conclusion, we have seen that Greece's economic problems include a huge accumulated debt it cannot service, significant public sector deficits, tax evasion, and inefficient public sector. In addition to this, there is corruption, lack of competitiveness caused by union power increasing wages and salaries, "closed" sectors (including trucks, taxis, pharmacies, engineers, lawyers, notaries), and lastly the fixed exchange rate (the Euro).

Although the EU & IMF provided Greece with loans (€110b) asking for reduction of public deficit and liberalization of "closed" sectors from the first bailout in 2010, this did not show the desired results because the EU, the IMF, and Greece focused on a short run perspective

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<sup>70</sup> *Debtocracy*. Dir. Katerina Kitidi, Aris Chatzistefanou. The Press Project. 6 April 2011. Movie.

(which basically just postponed the problem and bought time). There were constant disagreements regarding measures, and most of the requirements in the first bailout were unrealistic. The Greek government had difficulty implementing the agreements and stated requirements, and basically lost it's a large amount of its sovereignty to the lenders which included the EU, IMF, and European Central Bank. The recession continued and deepened, and unemployment only rose after the bailout.

A major problem is that Greek sovereign debt keeps growing- it reached €329 billion at end of 2010 and €368 billion at end of 2011. Although the EU/ IMF loan of 2010 promised Greece €110, Greek debt held by private parties stood at €210 billion. Greek GDP was €230 billion in 2010 and €215 in 2011, and Greek sovereign debt was 145% of GDP at the end of 2010 and 169% of GDP at end of 2011. Greek debt is constantly growing partly due to various large and unpayable expenses; for example, despite cuts in public sector expenses, the Greek public sector had a budget deficit of 10% in 2010 which increased debt. In addition to this, the severe recession in Greece “reduces the GDP and therefore increases Greek sovereign debt as a percentage of GDP”.<sup>71</sup>

It is almost impossible for Greece to fully pay back its debt. Even if Greece had “public sector surpluses (but it has an over 10% deficit instead), debt reaching 150% or more of GDP cannot be fully financed from the surplus, even at a relatively low interest rate of 4-5%”. The yearly interest on Greek sovereign debt is also €17.5 billion , or about 21% of public revenue, an amount that is clearly unsustainable. The interest rates on Greek bonds range from 497% (1-year), 197% (2-year), 52% (5-year), to 21% (30-year). The country has to reduce its privately-

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<sup>71</sup> Economides, Nikos. " The Greek crisis, why bankruptcy is a bad option, and why leaving the euro is the worst option". 12 February 2012. Online PowerPoint. *Stern School of Business, New York University*. 7 March 2012. <[http://www.stern.nyu.edu/networks/Economides\\_Greek\\_Debt\\_Crisis\\_02122012.pdf](http://www.stern.nyu.edu/networks/Economides_Greek_Debt_Crisis_02122012.pdf)>.



held debt, a measure that has been taken with the 50% haircut introduced. This includes a voluntary restructuring of the €200-250 billion of Greek debt and a voluntary exchange of old debt with new debt that will have longer maturities ranging from 30-50 years; 15% of the principal will be paid by the EFSF and 35% of the principal will be paid by Greece. Although the debt restructuring has many positive aspects, there are still problems and setbacks. Greek banks have about €40 billion exposure to Greek bonds and less than €5 billion total market value and will take an accounting loss of €20 billion (although these losses have already occurred banks do not show the losses in their books). Thus, restructuring will lead to an accounting recognition of the existing losses which in turn will lead Greek to recapitalize.<sup>72</sup>

## **ii. Option 1: Acceptance of Second Bailout & Private Sector Involvement**

Greece has accepted the second bailout, which focuses on private sector involvement, acceptance of lenders' demands, loan restructuring, and the new €130 billion additional loans. The main measures are to cut the private sector minimum wage by 22% (a wage that is already relatively low), lay off 15,000 out of about 800,000 civil servants, (in addition to reducing civil servants by 150,000 over a 5-year period), reduce the ever-present tax evasion, reduce supplementary pensions that were supported by investments in Greek bonds, and lastly receive an € 100b loan plus a € 30b for banks' recapitalization. All these measures seem only reflect further harsh times for the Greek people, and possibly a failure of what is intended to aid the Greek economy (as was shown through the 2010 bailout). Still, the option is better than defaulting.

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<sup>72</sup> Economides, Nikos. " The Greek crisis, why bankruptcy is a bad option, and why leaving the euro is the worst option". 12 February 2012. Online PowerPoint. *Stern School of Business, New York University*. 7 March 2012. <[http://www.stern.nyu.edu/networks/Economides\\_Greek\\_Debt\\_Crisis\\_02122012.pdf](http://www.stern.nyu.edu/networks/Economides_Greek_Debt_Crisis_02122012.pdf)>.

### iii. Option 2: Default & Leave Eurozone

Another option of Greece is to leave the euro, which might actually lead to a worsening of the debt. As previously mentioned in the comparison to the Argentinian crisis and its default, if Greece leaves the euro, its “new drachma” will be greatly devalued: the old drachma to euro about 340 dr = 1 € and the new drachma to euro might reach 1000 Ndr = 1 €. Since the debt is in euros, it will “suddenly get multiplied by 3 in new drachmas”.<sup>73</sup> In addition to the devaluation of its currency, Greece will not have the support of the EU and will be forced to borrow at very high interest rates (1-year: 497%, 2-year: 197%, 5-year: 52%, 10-year: 33% 30-year: 21%). Thus, it might still remain unsustainable and the debt might not be able to get repaid. In addition to this, it might result in huge inflation in Greece (where an extremely large amount of products are imported), and prices in Greece will be multiplied by 3; this will lead to horrendous effects, as wages and pensions cannot adjust quickly, and Greeks might actually become much poorer. There might be extreme poverty, as everything becomes three times more expensive. In order to pay public servants salaries and pensions, Greece will “print too many new drachmas, thereby creating an inflationary spiral”. This will eventually lead to hyperinflation, as the printing of money might become so widespread and a temporary fix/solution.<sup>74</sup>

Regarding the banks, if Greece leaves the euro, it will lead to bank collapse because “depositors will withdraw their euros (what little is left in banks) because they will not trust the government to convert them to new drachmas at the “right” exchange rate” and the “ECB will withdraw its lifeline of about € 116 billion cash to Greek banks”.<sup>75</sup> There will be complete social

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<sup>73</sup> Economides, Nikos. " The Greek crisis, why bankruptcy is a bad option, and why leaving the euro is the worst option". 12 February 2012. Online PowerPoint. *Stern School of Business, New York University*. 7 March 2012. <[http://www.stern.nyu.edu/networks/Economides\\_Greek\\_Debt\\_Crisis\\_02122012.pdf](http://www.stern.nyu.edu/networks/Economides_Greek_Debt_Crisis_02122012.pdf)>.

<sup>74</sup> Ibid.

<sup>75</sup> Ibid.

chaos, probably much worse than what we have seen through the protests and strikes. Greece may also have national and political incentives other than the economic reasons to stay in the Eurozone at the core of the EU. There might also be danger for Greece as it is a such a small country relative to many of its neighbors which are much stronger financially and have much larger powers (especially as part of the European Union). Greece basically needs most of the support the EU and the US.

## **Conclusion**

### **i. Final Proposed Solution**

Although each of the above choices has its positives and negatives, the best option for Greece at this point in time would be to stay in the Euro and not default- at least not yet. This might be the last chance Greece has to try to make things right, and the situation is far more complicated than many think. The largest setbacks of staying in the Euro include losing sovereignty and increasing its debt (at least in the short-run), but as stated previously, it might be the best solution at the moment. A default would not necessarily mean it is far worse an option than choosing to stay in the Euro, although the short-term consequences would be far greater than choosing to stay. Can the country attempt to declare its debt odious? It will be very hard to do so, but there can be cases proven where loans and substantial amounts of money were taken that did not benefit the society as a whole and thus they should not have to pay them back. If an audit committee performs thorough investigation regarding these loans and finds where that money went, it can prove that it was not for the benefit of the people. This will be very hard to do, but nonetheless can be done.

Another possible additional option is to take advantage of some natural resources, such as the vast amount of crude oil reserves. Greece's oil is centered around different areas around the Aegean Sea, specifically near the island of Thassos. Regal Petroleum also announced that the Greater Kallirachi field in the North Aegean Sea holds up to one billion barrels of light crude (findings that have been confirmed)<sup>76</sup>. Greece can make a contract with a major oil company or parties interested in extracting the crude oil, and receive prepayment of sorts for the drilling rights. Since there are such large amounts of crude oil, this amount would clearly be significant and can aid the Greek people and in improving the economy.

Lastly, this can be seen as Greece's last chance to try to improve their economy, but the costs still weigh heavily on the Greek people that did not play the role in this catastrophe. The future of Greece will remain uncertain, but there is always some hope, as Greece has managed to come out and bounce back from previous extremely harsh conditions.

## **ii. Recovery**

Although various reforms have been made, there is a very long path to recovery even though a bailout has been given and a default has not been announced. Reforms might include "freeing up the very rigid labor market of the past, opening up the so-called "closed professions," increasing the retirement age, and consolidating wages and pension funds by 2015";<sup>77</sup> in addition to this, there should be focus on the restoration of key institutions, focusing on property rights and security of title. There seems to be a path of reform to deregulate and simplify

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<sup>76</sup> Wolf, Niko. "Adjusted estimates of Greece's crude oil reserves are continuously rising". Volatility Management. 17 June 2011. Web. 1 May 2012. <<http://www.volatility-management.com/?p=961>>.

<sup>77</sup> Panaritis, Elena. "The Historical Roots of Greece's Debt Crisis". The Globalist. 13 May 2011. Web. 2 April 2012. <<http://www.theglobalist.com/printStoryId.aspx?StoryId=9131>>.

bureaucracy, and a possible solution to all the problems can only be found if the formal economy becomes “simple, predictable and, therefore, easy to track”. Any rules must “be applied even-handedly, with appropriate pricing of risk and minimal informational asymmetry, which usually benefits those who have accumulated considerable economic power — and thus stifles innovation, risk-taking and entrepreneurship”.<sup>78</sup>

There is an “underlying risk and the devastating effect of bad rules and processes and inappropriate institutions, and that they not only lead to “persistent distortions, but also systematically diminish economic growth”.<sup>79</sup> The necessary actions needed at this time under these circumstances involve ridding corruption in the government and restoring the faith of the Greek people in the government. Even if policies at this time seem unfair to the Greek people, which many are (such as decreasing pensions and public sector wages), these might temporarily aid in reviving the economy, and would mandate personal changes and acceptance of a different type of lifestyle. The 2009 crisis might be seen as both the largest problem or the possibly the largest opportunity to make change in a country marked with years of problems and corruption, and continue down a path of prosperity.

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<sup>78</sup> Panaritis, Elena. “The Historical Roots of Greece's Debt Crisis”. The Globalist. 13 May 2011. Web. 2 April 2012. < <http://www.theglobalist.com/printStoryId.aspx?StoryId=9131>>.

<sup>79</sup> Ibid.

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