

# Sovereign debt crisis assignment

Business



It can further be analyzed that the Greek debt crisis has caused a huge loss of incentives created by the European political environment and the institutional structure of Economic Monetary Union. Throughout the whole literature review, we are able to see how European Union restructures its institution through promoting both economic and political convergence. Key Words: Greece rises, Causes on European debt crisis in Greece, Impact of the crisis, Ways to mitigate the crisis.

Table of Contents European Debt Crisis in Greece 1 Introduction 4 Causes of European Debt Crisis in Greece I) Weaknesses in economic structure 7 ii) Relevance to the International Banking Crisis 2008 8 iii) Complications of the Treaty 9 Impact of the crisis in Greece I) Decrease in national saving rate 10 ii) Reduction in public health spending 10 iii) Increase in suicide rate 10 iv) Complex financial instruments 11 v) Decrease in wages and salaries 12 vi) Poverty effects 12 Ways to mitigate the debt crisis in Greece I) Rescue package 15 ii) Austerity measure 16 iii) Leaving Rezone 16 iv) Increase competitiveness 17 v) GAP linked Warrant 18 Conclusion 29 References 23

1. Introduction European Union was a union form by 28 members which located in Europe including several strong economic background countries such as Germany and France. Members are required to have good economic performance before entering as a member in European Union. EX. has formed system which has the authority to control to these members. European Union has many institutions providing service to their member for example Europe parliament, Justice Courts of Europe and European Central Bank.

Headquarter of EX. is place in Brussels, Belgium and Europe Parliament has their election over 5 years by European Citizen. Justice Courts of EX. is where handle the cases cross country which include EX. members, it providing equality trial for the EX. citizen. The role of European Central Bank is provides price stability within the Rezone and control the inflation through monetary policy. CB also has the authority to print their money, Euros which used by the entire member in EX.. European Union main objective is providing a good relationship in between Europe countries and giving trading platform between EX. members. European Union has one a great Job in term of economics and securities.

However, starting from the year of 2008, EX. has facing a great challenge on economic downturn in several members. PASS, Portugal, Ireland, Italy, Greece and Spain are main victims in the crisis which these countries suffer in high debt and high unemployment. These countries have a high unemployment rate up to average 10% and debt to GAP ratio over 100%. Greece was the main and first known victim in the European crisis. Inside this literature review, we discussed on cause, impact and solution for Grace's crisis. We will look into the causes triggering the Grace's debt crisis. As for the causes there are three causes which lead to the debt crisis.

They are as follow; the weakness in the economic structure, relevance to the International Banking Crisis in 2008 and complications in the Treaty. Several reasons discuss by the economist claimed that lead to the collapse of the Greece. The crisis let Greece fall into an economy downturn and this initiated a series of matter for their economic status. In the paper, we can see how the crisis affects health in Greece. We also look how government reduce <https://assignbuster.com/sovereign-debt-crisis-assignment/>

expense could affect the country, including healthcare and public servant. We also discuss on the income of Greece citizen after hit by debt crisis. Government has a series of policy in saving the country economic downturn to mitigate debt crisis.

Greece government has applied austerity measure in order to obtain rescue package as financial assistance for the bank bailout and maturing debt. Greece also needs to increase their competitiveness in order to obtain more revenue and increase their GAP. There also suggestion for Greece to leave Rezone and we will discuss about the advantages and disadvantages on it. Last but not least, we deliberate on issuing warrant linked wit GAP which done by Argentina in 2005 during their crisis. However, the situation in Greece has not improved much up to expected level. There is a lot critique on Greece government slow reaction and insufficient effort dealing with the crisis.

The Greece debt crisis started in the year 2009 where one of the largest rating companies downgraded Greece bond to a low rate and mentioned that Greece has the opportunity to default their debt (Greece timeline 2012). Austerity measure has been reveal in the January 2010. During March 2010, Greece finance minister claim Greece has suffer in budget crisis and may have no sufficient money o pay the maturity bond. They were asking for finance assistance from the European Union and MIFF, and immediately issue rescue package for Greece. In July 2011, Greece situation have no go better and requiring for next rescue package. Throughout these years, Greece still does not solve the economy downturn as unemployment rate strike to nearly 30% and debt to GAP up to 130%.

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The Greece crisis still remains unsolved after policies apply to the economic downturn and there is no significant decrease in unemployment rate and debt to GAP level. There is no clear solution for Greece and no optimistic on Greece situation, however there is caking research regarding method could be done if Greece bankrupt or default after fail to obtain bailout money from the CB or MIFF. The high dissatisfied citizens have no Job and no income lead to more social issues. There is least paper stated the relationship in between economic downturn and social issues. Greece debt crisis is an on-going crisis with some policy implied and no significant improvement for their economic performance.

This literature review gives a clear view on the situation of Greece regarding the roots of debt crisis, the impact toward the country and citizen and also the solution made by Greece government. Moreover having this literature review, it help others countries understand the root of debt crisis happen in Greece and prevent method could be made in order to avoid crisis happen in other countries. Besides, it helped people to understand to upcoming effect on the country which may help countries to find solution to comfort their citizen. Next, this literature review provides some example for countries regarding policy made by Greece is not a bright choice. They could avoid adopting these policies as there will not much benefit from the policy.

The literature review could help investor understand the situation in he Greece and make their decision to pour in their money into Greece or not. With this literature review, investors tend to find out the problem within Greece and search for investing opportunity. Risk lover investor would find this is challenging as much of the people have bad view on Greece, if they <https://assignbuster.com/sovereign-debt-crisis-assignment/>

could find an opportunity and turn it into profits it will get a high satisfaction. Greece bond has been rate as Junk bond in the market; however with the help of EX., it could actually make Greece back to track and possible paying the yield which is higher than any national bond.

Minister from the other country could find this review as understanding on the policy would not work for a country in debt crisis. They should also avoid the step Greece did to prevent debt crisis in their country. This literature review will give reader an idea of the Euro debt crisis in Greece which the first European members suffer from the debt crisis. It will provide the reason activate the debt crisis in Greece during 2009. It also shows the impact hit on Greece during the debt crisis happen where the impact makes the crisis worst and criticism by the international. Finally we will inquire elution to mitigate the debt crisis; this is where some solution d d by the Greece government and also solution proposed for Greece to come out from the economic downturn. 2.

Causes of European Debt Crisis in Greece Before proceeding with the analysis of the aspects concerning on the causes of the crisis, this segment would provide the fundamental timeline which are relevant to the proceedings of the debt crisis in Greece itself and reasons of as to what had put them in such situation in the first place. \* Weaknesses in the economic structure. The first cause which lead to the European debt crisis in Greece is the lacking of economic supports based on its structure. Since there lays a variety of in terms of the interpretation, the convergence criteria and the Stability of Growth Pact (SSP) did not seem to work out ways to prevent financial and economic crisis in the future. Generally, the convergence <https://assignbuster.com/sovereign-debt-crisis-assignment/>

criteria were applied based on the strictness of a country compared to another.

According to Featheriness (2011), this is one of the reasons which led Greece to enter the Rezone where else in reality; it did not meet the convergence criteria on the government deficit of 3 percent of GAP ceiling. Although Greece did not join the Rezone till year 2001, the public debt in Greece has been consistently high since it has fluctuated in estimation of 100 percent of GAP from 1993 onwards (Featheriness 2011, 198). Greece was actually allowed to join due to the convergence criteria not being applied correctly which based on one's opinion, is either a failure in the structure of the criteria or decisions made by the European leaders led to political failure. However, this does not mean that other countries are not involved in the fabrication of the convergence criteria as well. According to

Arroyos and Outclass (2011), governments of year 2001 to 2009 has not implemented sound economic policies which have then allowed further deterioration of the basics since Greece has been stipulated by the weak economic convergence. This applies for the SSP as well when it has lost a great deal of power in year 2002 and 2003. Due to the German and French having to run in public deficit in this particular period which has directly broken the rules of the SSP and has effortlessly been outvoted by associated small states and the European Central Bank (CB) Executive board given their preference for lower interest rates at that time (His and Holland, 2011, 263). Under normal circumstances in the rules of the Pact, if Germany and France were running on large deficit, the two countries would have to face sanctioned sentence.

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But however in November year 2003, Germany and France has persuaded some of the Member of the States to revoke the procedure of disproportionate deficits. By getting the enraged Commission behind their tails has led to the European Court of Justice (ACE) taking the case. In the support of the governments, CEJ has taken the stand and won over. It can be further concluded that SSP is then declined from its current state (His and Holland, 2011, 267). Relevance to the International Banking Crisis 2008 The second cause of the European debt crisis in Greece can be seen in its relevance and seemed to have a connection with the International Banking Crisis in the year 2008.

In every country, the specifics of the banking crisis are said to be different but however, a member tot the Chit Economist Team tot the Directorate General Competition, Stan Mass has clearly stated that the main cause of the crisis seems to be the monetary policy applied in banks and their roles in the monetary system (Mass and Slaking, 2009, 13). The reason why financial crisis was important to Greece at first was because of the country incompetence to compete in the aspect of economy, having weaknesses in the administration, and widespread of tax evasion in the key sectors. In order to prove this point, the European of Commission has estimated that around 30% of Greek taxes or 3. 4 of the Greek GAP were unpaid (Featheriness, 2011, 196). Greece was very much vulnerable when the international credit crisis broadens in year 2008-2009 showing the country has lacked of competition and sustainability of current account deficits in the foreign trade (Featheriness, 2011, 198).



Unable to pay back their debts, the Greek government achieved returns under their expectations on the Greek project which then gradually reduces the price of the Greek bonds and cornering with losses which significantly under the global credit awakening (Argosy and Outclass, 2011, 180). In the awakening of the crisis, the Greek government did not take in any corrective measures in thought of the upcoming Greek elections. To put it simply, it meaner that the Greek government acted carelessly with its fiscal policy and debt accumulation which further results having to face the consequences of having transparent weaknesses in the economic environment which becomes more apparent in the wakening of the global credit crisis.

Complications of the Treaty In the structure of the Economic Monetary Union (MME), it has created bad incentives for the banks to make purchase on Greek bonds which would intensify the risks of liquidity for the banks in Greece. Usually, when it comes to the incorporation of risk factors for investors, the risky Greek bonds would automatically be assumed to preserve higher interest rate rather than German bonds who would only play it safe. Grumman (2011) further stated that in the pricing mechanism that the MIX, the formerly known as the high interest rate countries went to a predictable path hereby they went on a borrowing spree across Europe.

The reason why the current debt situation is a problem because it actually affects the European banking as a whole since the borrowing spree was actually financed by Germany and other low interest rate countries.

According to European Union (2010), the current European treaty, last amended by the Lisbon Treaty has included the ' no bailout clause'. In the Article 125, it has stated that individual members of the state and the

European Union “ shall not be liable for or assume the commitments or public undertakings of any Member State”. It has been clear that the market never did believe Article 125. This also has incurred that the German and French government could not allow their held substantial proportions in the banks to default despite the restrictions stated in Article 125.

However, when a Member State is faced with difficulties caused by natural disasters, it can be considered to be under the exemption circumstances due to the nature of being beyond control. The Member State would be offered financial assistance by the Union under this special case. This can be said to be the contradiction to the ‘ no bailout clause’ in Article 122 (European Union 2010). Generally, it can be said that the current debt crisis is overthrowing whose responsibility to bear the bank losses. Like was stated by Algerian (2011), the decision made by the EX. governments is to protect the banks bondholders at all cost in order to lose the costly bailouts. Adhering to the letter of the Treaty, Greece has received bailouts in terms of voluntary loans instead of direct financial aid. 3.

Impact of the crisis in Greece \* Decrease in national saving rate Greece crisis has directly affected most of the Euro countries. One of the impacts will be the national saving rate has been declined. Declining in national saving in Greece has increased the deficit amount of the current account and foreign debt. Greece has been experiencing negative net foreign asset position with GAP of 3% since 1997. However, the deficit incurred has increased from 3% to 86% since 1997. Greece is having the largest net foreign debt among developed countries which also lead to the arising in the public debt-to-GAP ratio increasing from 102% in 1997 to 115% in 2009. The average account

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deficit of GAP is 8.3% per annum. In addition, the budget deficit was constantly stand at 5. Per annum on the same period which indicated that the public sector and private sector could not solve the deficit and also contributes to the country net foreign debt (Margarita and Thomas 2010). In an open economy, if domestic investment is smaller than domestic saving, the government able use domestic saving to solve their debts. However, Greek is having low national savings over national investment which indicated that their deficits from borrowing need to be covered by the public sector and private sector. In this instance, the deficit interest payments will be high when the country borrows from the public which had also increase the public debt. Thus, due to the high public debt, foreign investors would think that do the government of this country able to generate profit to settle their debt or not.

Based on Margarita and Thomas (2010), Greece has made 3.8% of GAP for debt payment in 2009 and it is expected to increase to 5% in the future. Greek needs to reduce their government spending, citizen consumption and investment in order to continue pay the debt payments. Besides, if Greek citizen save 5% of their income monthly, it will causes Greek suffer in large recession which will lead to higher foreign debt burden and a highly possibility to default payment. Due to the foreign lenders request for higher interest rates which has increase the probability of default, the Greek government need to look for help to eliminate the default risk. Increasing of suicide rate Moreover, the economic crisis in Greece has been a burden for the citizen which increases the rate of suicide. According to the Greek Ministry of Health, the suicide rate in Greece has increased by 40% and it is

due to high economic distress (Economic et al. 2011). After investigation, it is reported that there was a 36% increase in attempted suicide in the month before the survey which is 1 in 2009 or 1.5% in 2011. In addition, the recession in Greece has caused the increase in suicide and suicide attempts. Therefore, Greece needs to maintain a social welfare state to reduce the rate of suicide. \* Reduction in public health spending Furthermore, Debt crisis In Greece also harm the public health system of the workers.

International Monetary Fund (IMF) caused Greece to reduce in public health spending. In 2009, Greece has enforced fiscal austerity programmes on public health spending which leads to negative effects on workers' health as the government reduce aids from public health (Noon 2011). IMF reacted by mentioning that the spending on health is not reducing and stating that Greece are not forced to decrease social spending during the support programmes. However, Greece has reduced their intensive care units in which thousands of public health workers and doctors will be fired which allow them reduce spending of €2.122 billion until 2015 (Traditionally and Unstoppable 2011).

National Statistical Service has stated that Greece has spent €25 billion per year on medical services (Karamazov 2011). However, national hospitals owed €6.5 billion to their suppliers, and €1.2 billion to drug companies. In a time, Greece has cut down their expenses for every public sector including the health sector but it still could not decrease their spending. Greece has spent 7% of the national expenditure on health is on medicine and this amount does not include the drug companies that has

directly sell it to the hospitals. Thus, the government intended to cut down on medical costs by refinancing the operational cost of hospitals.

The use of full operations the in-hospital electronic drug prescription system can reduce the operating cost. \* Complex financial instruments Besides, research shows that Greek government has been using complex financial instruments to cover up the real level of debt that Greece has been facing. For example, government of Costa Agrarianism stated that Greece can obtain revenues by exchanging highways, airports as prepayment from investors. Furthermore, Greek government borrowed billions to trade currency at favorable exchange rates which considered as currency swaps (Rebecca, Paul and Derek 2010). The financial instruments in Greece's debt crisis have get attention from the United States and the EX. financial regulation.

Some of the European leaders requested to tighten the financial regulation and prohibit the supports towards Greece to solve their debt rises. \*

Decrease in wages and salaries Wages and salaries in Greece were paid in the form of installments. Installments can be divided into 14 months. In 2010, the 13th and 14th salary paid has been abrogated. For public servants, part of their benefits which is special allowances has been reduced by 20% whereby allowances for public utilities employees also have been deducted by 10%. Therefore, it has led to a resulting in declining of average gross earnings in the terms of 13. 6% for public servants in 2009 whereas 9. % for public utilities employees (Maintains and Cherry 2011). Apart from reducing in ages and salaries, the unemployment rate in Greece has been also affected. Result has showed that overall unemployment rate in Greece has <https://assignbuster.com/sovereign-debt-crisis-assignment/>

risen from 7.7% in 2008 to 12.5% in 2010. From the recent news, it clearly showed that unemployment rate in Greece has increase up to 27.6% in May 2013 (BBC News 2013). \* Poverty effects Poverty effects are also affected by the crisis. The poverty results are measured by the demographic factors and the employment status of the household. According to Mason and Eleventh (2011), the standard poverty rate (60% of median) has risen in a small percentage which is an increase of 0.5% from 2009 to 2010. Through the observation on the effects on specific demographic groups, the poverty rates has increased widely where there is close to percentage tot household who worked in the public or banking sector and there are more than 40% of household who are working as a farmer or unemployed. In addition, the crisis has further worse off the household with an employed head which the poverty rate increase approximately by 9 percentage points which is from 51.09% to 60.14% as shown in table 1. In additional, the most affected age groups caused by the crisis were generation X who geed between 30 to 44 years old in the rise of unemployment.

As compared to lower poverty standard which is 40% of median equalized disposable incomes, the poverty rates are moving in a similar pattern as standard poverty rate. The poverty rate increased 0.05% from 7.3% in 2009 to 7.8 in 2010. Besides, households with an unemployed also worst off in which the poverty rate increase approximately 3.7% which from 34.77% 2009 to 38.53% in 2010 (Mason and Eleventh 2011). At this point, the unemployment rate is almost reached to the lower poverty standard. The lower poverty standard with median of 40% detail is shown at table 2. Through using poverty threshold anchored at time framed, which is 60% of

the median of 2009, the overall poverty rates increase more than 5 percentage point to 25. 2%. This result is present for all age groups and occupational categories.

Furthermore, the households experience a higher poverty risk which has increased 12. 6% of poverty rate from 2009 to 2010 and hit the highest poverty rate of 63. 7%. Table 1: (Mason and Eleventh 2011) Table 2: 4. Ways to mitigate the debt crisis Greece as one of the major Rezone crisis country has suffered with high unemployment rate and high debt level to GAP.

Solutions are needed to save Greece from the bad economy performance.

There are several solutions has been proposed for Greece. \* Rescue package Greece has suffering with budget deficit and lack of money, Greece has request financial assistance from European Central Bank and International Monetary Fund for rescue their bank bailout and maturity debt during 2010.

Before the bailout money given out by Rezone, Euro members have debate in between member for the loan with Germany as the leader of opposed and France was the favorable on giving rescue package. To prevent the whole failure of Rezone, Euro member has decided o provide rescue package for Greece to pay their debt and upturn their economy. CB and MIFF have agreed to loan Greece \$110 Billion Euro within three years with respectively low interest rate (Rebecca, Paul and Mix 2010). Euro Central Bank takes 80 billion in the 110 million and MIFF holding the other 30 billion Euros.

Immediately during May 2010, Greece was received the thirst tranche which contain tot 2 Euro of bailout money. Within the next several months, Greece receives the remaining agreed loan by several trenches.

However, the 110 Billion was been verified insufficient to repay the debt and save the local economy, therefore Greece as request for the second rescue package from Rezone. EX. member held a meeting in Brussels to make the decision as second rescue package to Greece with 100 Billion Euros for bailout money. The repay session has been extended and the interest rate was once again being lowered too lower level (Visit 2012). However, the third rescue package is not optimistic for Greece because some of the member has felt Greece is a black hole where lender may lose their money and Greece economy has no improvement. It also may bring down the value of Euros (Gram \* Austerity measure 2011).

In order to obtain the rescue package, Greece has stated several austerity measurements as an effort to convince Rezone and MIFF for bailout money. The main target for the austerity measures is to reduce expenses and increase revenue in Greece (Visit 2012). Greece parliament has passed the fiscal policy although high resistance from the public. According to Gourmets and Villas (2010), Greece government increase VAT rate with 2%, from 21% to 23%. This is one of the consumption taxes which added into purchase price. Greece government expecting to receive approximately receive additional 0. 8 billion Euros in 2010 and 1 billion Euros in 2011.

In additional, increase indirect tax also one of the fiscal policy by Greece. Taxes increase for fuel, tobacco and beverage product where the government expecting to receive addition 0. 5 billion Euro for the coming two years. They also levy taxes on luxury good and company with high profits. Greece are looking to imply green tax in the country, however this action known as controversy because businessmen criticize the introduction <https://assignbuster.com/sovereign-debt-crisis-assignment/>



of green tax in Greece is not due to environment friendly step but just a step for government to obtain more tax. Some also mention that by reducing the corporate tax, it actually enhances company production as they will have a higher morale on production.

Besides increasing revenue, austerity measures also include reducing expense by the government to stabilize the economy in the short term.

Public servant has become the victim in the austerity measure. The civil servants' who earning more than 3000 Euro per month, their annual salary installment has been abolished. Part of their employee's benefits also been terminated by the government to reduce the operating cost. Central government operating cost is looking to diminish in order to reduce wasting. Greece public investor which operate by the government are looking to reduce by 0. Billion Euro. However, this also creates a political issue, which also led to riot and employee strike in the country.

One of the reasons slowing down the recovery is because ruling political party has to balance them in recovering economy and citizen's mood. Therefore, the austerity measurements do not improve much on Greece recovery performance. \* Leaving the Eurozone In the other hand, Greece has proposed to leave the Eurozone in order to be able to use its own currency instead of Euro. Within the Eurozone, there are a lot of free trade agreements and using Euro as their currency which initially benefited Euro members. This agreement could help Greece in exporting their products and increase tourism, which can ease the tourist trade in the Eurozone because using the same currency. Tourism is one of the major incomes for the country. However, by staying in the European Union and using Euro as their currency has caused problems for Greece.

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Greece could not have their own monetary policy to stabilize their economy by adjusting the interest rate to control inflation (Gourmets and Villas 2010). Obviously European Union monetary policy is not suitable to the entire member as Germany is the power horse among the member and Greece is below the average, the huge gap in between EX. members reference lead to difficulty to find balance position or suitable monetary policy for each member. Greece also has no authority to print their currency or affecting the value of currency, where some of the country paying their debt by printing money, for example US has quantitative easing measure during Global Financial Crisis.

Therefore, by leaving the Rezone temporally and by producing own currency and it could help to reducing debt level of the country. Leaving Europe Union, Greece could use monetary policy to control the inflation rate. In addition, budget deficit problem ay minimize through having own currency as Greece has too less product to export but highly on import, using the new currency which believe will be devalue compare to Euro believed will increase exporting in Greece and decrease importing as export has become cheaper for Greek. Conversely, leaving Rezone also bring in uncertainty or larger risk to Greece which may accelerate Greece into bankruptcy.

Most of the rescue package bailout money loans are come from CB which approximately 80% of the rescue package, leaving Rezone will lead Greece to lost one of his biggest financial support with existing of Germany and France in Rezone. As well Greece wills immediately facing debt owner looking to obtain their debt instantly as Greece may face bankruptcy and default issue. Moreover market would not lend money to Greece as their high <https://assignbuster.com/sovereign-debt-crisis-assignment/>

debt level and lost their financial backup. Since Greece bond has been rating to a low level, it require Greece to set higher rate and there is no much market willing to purchase it, ascending Greece has the problem to accrue money from the market. Increase Competitiveness Increase competitiveness of Greece in the market is one of the solutions for Greece to move away from the bad economy performance. Competitive allow a country to enjoy rookeries on a sustainable foundation (Mightier, Banyans and Vets 2010). Greece economy has high unemployment rate and high debt level, Greece need a high productivity to overcome the low economy performance. Greece has good record on tourism however it is highly depend on the Europe country (Bliss 2001), as the Rezone has a downturn in the economy it eventually decrease the amount of tourism in Greece. Greece need attract more customers from different region in order to maintain the high income from tourism.

Greece should targeting tourist from the Asia region since Asia base customer has strong purchasing ability. Besides the ancient heritage and natural scenery available in Greece, they also need to increase tourism attraction in order to attract more tourists into their country, for example theme park, event and exploit islands. During year 2003 and 2004 when Athens held summer Olympic, Greece have the highest GAP growth for the decade (Global finance). Therefore, it is not hard to notice with event held in the country actually will bring in extra income and provide more employment chances. Madrid of Spain also tried to follow the foot step by held summer Olympic 2020 to slowdown