GREXIT

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Abstract:The asymmetric shock generated by the recent economic and financial crisis caused a rift between the eurozone countries, affecting, finally, the whole monetary area and the confidence in the functionality of the Economic and Monetary Union (EMU) project.This study outlines the causes of the severe imbalances accumulated by Greece which have become a threat to the stability of the European Monetary Union and paved the way for discussions on the Greek exit from the eurozone. The results of this analysis illustrate that the Greek crisis confirms that EMU is inoperative in the context of an association based on a system of rigid convergence and also in the absence of central fiscal authority, able to relate the internal imbalances.

Keywords: ***Greek crisis, exit scenario, debt default, imbalances, eurozone.***

INTRODUCTION

This study has as main objective to analyze the problem that is most often questioned, if Greece coming out of the eurozone will become a reality or not. In terms of accumulated debt default, Greece exiting the EMU seems inevitable. Greece has become the most indebted European Union Member State, competing with itself for years, and the so-called Grexit could have serious consequences both for the Greek state and its citizens as well as firms and foreign banks operating in Greece.

The present paper is structured in three parts. The first part contains a brief description of the literature that analyzes the Greek crisis and its scenario for the exit from the euro zone. The second part describes the Greek State history in EMU from the perspective of the main macroeconomic indicators' evolution during 1998-2014, and the last part focuses on issues aimed at the beginning of the end of Greece in the eurozone.

The paper ends with a set of conclusions that complete the scientific content by pointing the most representative aspects that the scenario of the Greek economy and Greek exit from the Eurozone analysis emphasizes.

LITERATURE REVIEW

The sequence of events in Greece has initiated various discussions and debates among economists, analysts and institutions, with the potential of a voluntary or forced exit from the eurozone and the consequences of such an event both for the Greek state and for its partners (Koutsoukis, Roukanas, 2014).

In 1974, public debt in Greece was 18% of the gross domestic product (GDP). In 1986, the debt reached 58% of GDP and the volatility of the economic growth, the high inflation, the devaluation of national currency successive structural weaknesses are partial causes. Greece joined the European Union in 1981, before Spain and Portugal, giving access to generous European funds, which can hardly be described as a prudent one. Thus, public debt continued to grow, reaching in 1996 the level of 113% of GDP. This was due, primarily, to the disproportionate social benefits, as well as wage and pension increases and early retirements, and, secondly, high deficits of private enterprises, which have created budget funding through a loan continuously (Halikias, 2012) .

Governments that followed in the Greek state began buying social peace and votes by means of various public expenses and state loans. Being in the euro area, governments were able to continue the wave of loans at low interest rates. Thus, Greece‘s deficits and debts did not appear overnight but were gradually accumulated in the last decades. In addition, irresponsible policies were tolerated for a really long time. (Jovanovic, 2012).

After the outbreak of the financial crisis in 2008, Greece‘s severe fiscal imbalances and high government debt continued with a deep recession and slow improvement of competitiveness. They have become a threat for the country’s solvency and stability and a bank failure in the Greek economy and a possible exit from the eurozone would involve huge costs for the global economy (Grubel, 2012).

A potential Grexit would be followed, first, by a devaluation of the national currency. However, devaluation could create the conditions for a recovery of the Greek economy competitiveness and the strengthening of Greek exports. According to economist Roger Bootle, the implications on the Greek bank deposits will reduce the Greeks’ purchasing power particularly regarding imports of goods and exchange (Bootle, 2012).

The effects of the macroeconomic Grexit would reverberate, primarily, on GDP, GDP per capita, unemployment, poverty and economic growth rate. According to estimations performed by economist Papoulis, the Grexit would lead to a fall of approximately 50% of the nominal exchange rate. The strengthening of the exports competitiveness would increase, but at the same time, the decrease in the exchange rate would weaken imports, and consumers should be directed to domestic goods. As a result of increased demand for domestic goods, we would find positive effects on employment rate, economic growth rate and the GDP. GDP per capita would decrease with imports and grow with exports. Regarding the macroeconomic indicator on the poverty level, it would be counteracted by increasing the employment rate of the labor force (Papoulis, 2013).

HISTORY OF GREECE IN THE EUROZONE

Since the first forms of the monetary union, Greece has shown interest in acceding to such unions. By joining the Latin Monetary Union, Greece registered both a strengthening of sovereignty and an early strength of the economy. The 2001 marks the entry of Greece into a new currency area, Economic and Monetary Union. Compared to other Member States, in Greece’s case, the accession strategies were characterized by a greater flexibility. Greece thus distinguished itself by an EMU entry model based on a more flexible exchange rate within the Exchange Rate Mechanism II (ERM II).

The decision to participate in the euro area is not exogenous, it derives from the countries' internal conditions and individual positions. Since the establishment of EMU, the decision factors in Greece considered that the single currency would promote convergence in terms of economic growth and inflation, but the experience of the fifteen years of the euro existence illustrates a very different situation.

Greece's entry into EMU at an exchange rate above average made the euro deficit and inflation appear smaller than they really were. The unjustified appreciation of the drachma before entering into the euro area held political requirements of statistics manipulation.

Before the moment of entrance into the euro area, most of the old Member States recorded relatively low levels of inflation, and many had obtained price stability. This positive situation was due to some structural changes, especially during 1990-1997, with the adoption of more restrictive monetary policies oriented towards price stability, supported by fiscal and wage policies, and fixed exchange rates. Nevertheless, rigid monetary policy, directed towards moderation in inflation, has also lead to the appreciation of national currencies, as happened in Greece in early 1998. On the other hand, fiscal consolidation has had a slow progress.

Most countries had not reached until 1996, a situation considered sustainable in the medium term. Therefore, they had to give special attention to issues of reality, not only to the accounting methods used to measure budget deficits and public debt to GDP. The fiscal consolidation efforts had to become stronger, as the debt level was higher.

For Greece, the threat of being left out of the eurozone was an impulse to make adjustments in the fiscal area. However, budget deficits have increased after joining the euro area.

Due to the level of nominal convergence indicators above their reference value in 1998, Greece has made notable progress in this direction, urging the Council to accept participation in EMU, the decision being based on the Commission and ECB reports in 2000.

Tabel No. 1 **The progresses of Greece in achieving the nominal test of convergence before the entry in the EMU**

Country	Year	HICP inflation (%)	Long-term interest rate (%)	General government surplus (+)/ deficit (-) (%)	General government gross debt (%)	Currency participating in ERM II
Greece	1998	4,5	8,5	-3,1	105,4	Yes – since March 1998 (without deviations)
	1999	2,1	6,3	-1,6	104,4	
	2000	2,0	6,4	-1,3	103,7	
Reference value	***1998***	***2,2***	***6,6***	***<3,0***	***<60***	***±15%***
	1999	***2,1***	***6,8***	***<3,0***	***<60***	***±15%***
	2000	***2,4***	***7,2***	***<3,0***	***<60***	***±15%***

Source: European Central Bank, *Convergence Report 2000*

Greece registered a considerable downward tendency of the inflation rate from 4.5% in 1998, thanks to wage policy that ensured a moderate salary evolution, both in the public and private sectors, to 2.1% in 1999, reaching 2% during the evaluation in 2000, with only 0.4% below the reference value. However, due to restrictive fiscal policy, the budget deficit was reduced from 3.1% in 1998 to 1.3% in 2000, and the gross debt level, although having had a downward tendency, over the same period, from 1998 to 2000, is well above the reference value, but lower than the level recorded in Belgium and Italy before joining the

EMU. Given the Council's abrogation of some early decisions on the existence of excessive deficits, fiscal criterion is considered fulfilled. Regarding the long-term interest rate, this indicator also decreased from 8.5% in 1998 to 6.3% in 1999 and subsequently in 2000 to 6.4%, 0.8% below the reference value.

As a consequence of these evolutions and of the fact that in the two-year period of participation in ERM, the national currency, the Greek drachma, has not been the subject of severe tensions respecting the normal fluctuation margins provided for by the exchange rate mechanism, the Council accepts Greece's request to participate in the EMU, becoming the twelfth member of the eurozone since 2001.

Tabel No. 2 **The evolution of the nominal convergence criteria in Greece, 2001-2014**

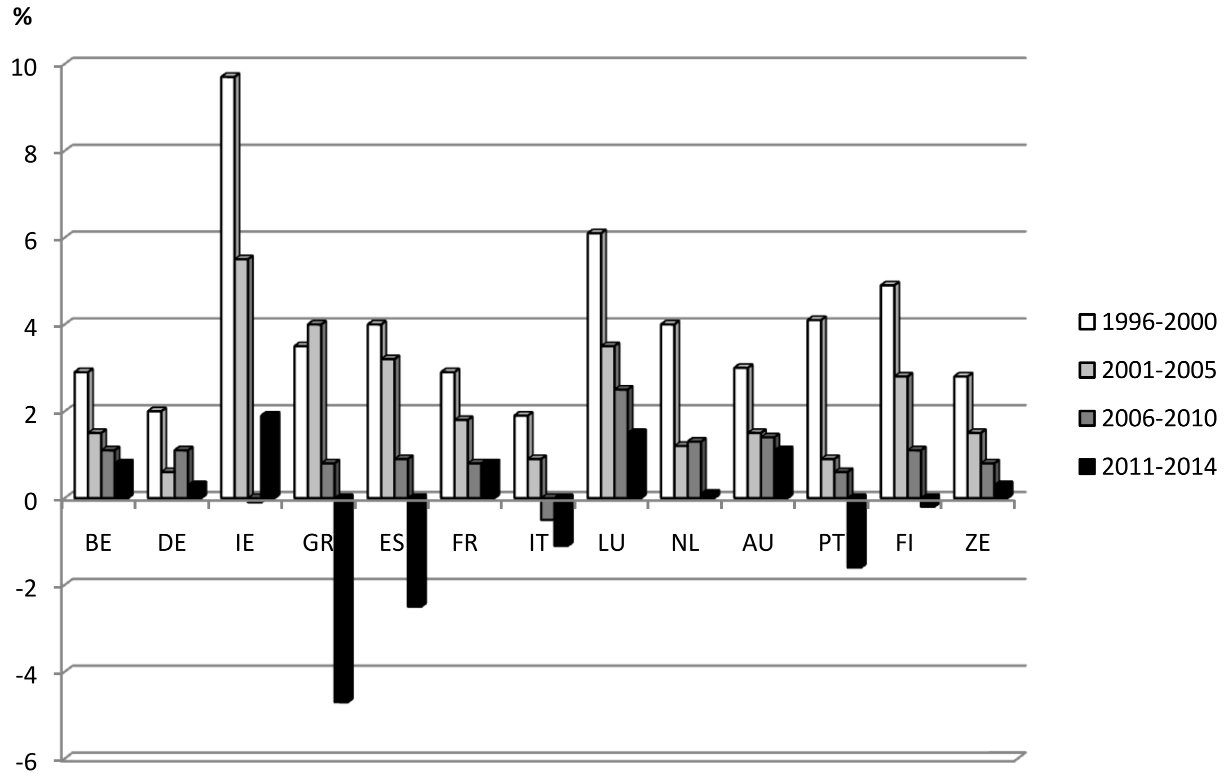
	HICP inflation (%)	Long-term Interest rate (%)	General government surplus (+)/ deficit (-)(%)	General government gross debt (%)
2001	3,7	5,3	-4,4	122,1
2002	3,9	5,1	-4,7	123,2
2003	3,4	4,3	-5,6	118,9
2004	3,0	4,3	-7,0	121,8
2005	3,5	3,6	-5,4	121,6
2006	3,3	4,1	-5,7	123,0
2007	3,0	4,5	-6,5	120,4
2008	4,2	4,8	-9,5	116,8
2009	1,3	5,2	**-15,2**	133,2
2010	**4,7**	9,1	-10,4	126,9
2011	3,1	15,8	-10,2	171,3
2012	1,0	**22,5**	-8,7	156,9
2013	-0,9	10,1	-12,3	175
2014	-1,4	6,9	-3,5	**177,1**

Source: Eurostat, World Bank

The table no. 2 illustrates the evolution of the nominal convergence criteria in Greece between 2001-2014.Greece has met the inflation criteria shortly before the evaluation in 2000 and only for a few months after it. After that there were overruns not only to this criterion, but also to the criteria on budget deficit and public debt. In Greece, the current account deficit of the balance of external payments represent about 15.2% of GDP in 2009, while the high inflation present each year, has eroded economy's competitive base. Currently, Greece's debt almost doubled compared to the value when joining the EMU, reaching 177.1% of GDP, the Greek economy taking the EU and the euro currency into a major crisis, whose resolution is presumed to be difficult. The assumptions that led to the situation where a country whose population was living at a European welfare level have made Greece to find themselves in a situation of quasi-bankruptcy that imposed unprecedented social sacrifices in Europe.

According to the data in the table below, during 2001-2005, Greece is the second country with a great tendency to increase the level of economic activity (GDP) above the euro area average, but then, between 2011-2014 it returns to the lowest average from the eurozone.

Figure No. 1 *Real GDP growth rate in the first euro area countries between 1996-2014*



Source: Eurostat

With the transition to the euro currency, the fiscal and budgetary situation has seen a steady deterioration in Greece. Since 2001, both the population and the authorities have embarked on a spiral of dangerous lending, spending much more than the income. The pursuit of short-term political advantages brought great harm to long-term economic development, fostering the widespread corruption, bureaucratic excess and, finally, political collapse when the public debt level was revealed to the citizens and the community authorities. Since 2009, we often hear about the so-called Grexit scenario, given the fact that Greece is dominated by political instability, reform jams and lack of will for savings.

THE BEGINNING OF THE END OF GREECE IN THE EURO AREA

A final discussed scenario on the crisis in Greece is the exit of the euro area, but the EMU's original plans, based on convergence criteria, did not foresee, even roughly, the effects of a Member State exiting from the euro area.

According to rating agencies, if Greece would exit the euro zone and would start using again a national currency, the country rating would be downgraded to junk category (speculative). Although this option was not accomplished, Greece still recorded a rating decrease to the junk category.

The specific vulnerabilities for each country played an important role in the financial crisis, which arises from regional differentiation within the euro area, generated by the initial shock, affecting, directly, those countries which followed an unsustainable growth model. Greece was developed based on excessive government spending, ignoring or tolerating the unsustainable development budget balance.

Despite the regular reporting system and some pretty clear provisions on the European monitoring technique, this mechanism has failed to foresee the strong growth in debt for the eurozone countries, including Greece. An explanation is given by the fact that European coordination process did not take into account the indebtedness of the private sector, very important variable in this context, linking the consolidated government budget balance and current account balance of payments. The deterioration of public finances in Greece has been fueled by excessive government expenses and insufficient tax collection, enhanced by a major imbalance between revenue and expense.

In Greece, the economic growth was based on the final consumption and the investment projects, which has generated a significant increase in imports. The current account deficit covered by foreign direct investment, such as the Greenfield type, oriented towards export activities, does not create long-term problems, while current account deficits that are not accompanied by an increase in investment in the export sector contributes to a permanent increase of the external debt with unwanted repercussions on medium and long term. Such a phenomenon has occurred in the Greek economy, foreign investment being made, especially in the non-tradable sector.

The global financial crisis, triggered by the shock of disbelief, showed that rules on budget deficit and public debt are not sufficient to prevent insolvency of the Member States in this monetary area. The recent developments in Greece show that even under the protection of the euro zone, a country's economy is not sheltered, as long as its structure is not suitable for a long-term sustainable development, given that the economy is perceived by investors as a risky economy or with political uncertainty created by internal divergences.

CONCLUSIONS

The present economic situation of the Greek state confirms that the formation of a common monetary zone is neither a necessary nor sufficient condition for a healthy economic growth. It seems, on the contrary, that the Greeks were involved in a rigid monetary arrangement that resulted in a significant loss of the initial flexibility.

In the current economic context, the benefits and costs of helping Greece remain a dilemma. The period of crisis faced by Greece, reinforces the idea that breaking the link between fiscal and monetary authority affects the sovereign debt of countries participating in the EMU.

We can conclude by saying that fiscal discipline is a key element in the management of any economy. The importance of fiscal sustainability in Greece confirmed that any deficiency can generate excessive macroeconomic volatility. No doubt that there are tensions between fiscal and monetary authorities in any economy, but more so, they can manifest in such a monetary zone, given that monetary policy is unique, and the tax is decentralized on the national level, the coordination between the two macroeconomic policies being much more difficult.

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