Impact of Greece Debt Crisis on World Economy

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Abstract

This study aims at exploring the reasons behind the Greece debt crisis that emerged in the 21st century and explains how the crisis made an impact on the world economy. Euro is a common currency used by all the countries of the Euro Zone which benefits them in trade and development of their economies. The Euro Zone treaty specified certain guidelines which restrict their members from borrowing more than 3% of their economic output but the treaty allowed poor European countries to borrow money at low interests from the rich and financially stable, like Germany. This government debt with time became so massive that it was nearly impossible for these countries to repay. The European Central Bank (ECB) was also held responsible for the Euro crises by allowing lower interest rates and providing cheaper loans of more than one trillion Euros, so as to maintain the flow of money between European banks. This study also shows the initiatives undertaken by private and public sectors to mitigate the declining effects. The study was conducted with reference to web based literature and the data is collected from secondary sources like newspapers, articles, journals and publications on European crisis from around the world.

Keywords

Euro Zone, Greece, Debt crisis, Euros

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Introduction

An economic crisis results from a situation in which a particular economy experiences a sudden downturn usually brought down by a financial crisis. Such an economy will be marked by the presence of events like falling GDP, drying up of liquidity and rise in prices due to inflation. An economic crisis can take the form of a recession or a depression. The European sovereign debt crisis is believed to be an extension of the Great Recession which turned out to be a massive financial crisis, making it very difficult for some countries in the Euro Zone to repay or re-finance their government debt without involving assistance from external parties.

The Euro Zone is an economic and monetary union of 18 European Union member states (Austria , Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia, and Spain) that have adopted the Euro (€) as their common currency.

Along with the government, The European Central Bank (ECB) was also held responsible for initiating the Euro crises by allowing lower interest rates and providing cheaper loans of more than one trillion Euros, so as to maintain money flows between European banks. British economic historian Robert Skidelsky added that "*It was European banks more than necessary lending and not deficit spending that created this crisis*."

What really bought into light and much into concern different facets of the Euro crises was the fact that the whole world was affected by its impact on them. As reported by Wikipedia (2014) over 330 million Europeans use Euro as their currency [1]. This currency is used for both internal as well as external trading and any collapse in the Euro value will reduce their buying capacity, leading to a major loss for those involved in importing their goods to Europe.

India's export to European Union declined when Euro crises hit Europe, thereby creating a net loss of 8.45 % in 2009-10 [2]. The importance of the European crises study can also be well determined from the fact that it had a direct impact on the world financial system, as banks around the globe had invested in the government debt of Euro Zone countries.

These banks also themselves hold large Euros. If the crisis keep continuing then the government debt and currency would fall in value to the extent that it could degrade their own financial well being. The story of American financial crises would have been repeated (like in 2007 and 2008) all over again, with the whole global banking system under threat.

Aims and Objectives

This study aims to explore the reasons for Greece crisis which emerged in the 21st century. The study was conducted with reference to web based literature and also orients to investigate the impact on world economy and steps that were undertaken to avoid such crisis in future.

Materials and Methods

For this study a search was conducted from systematic reviews and recently published studies on European crisis around the world. In addition, the reports and literature from various websites of bilateral agencies like United States Agency for International Development (USAID), newspapers and other available databases was also taken.

Results and Discussion

Though economically the Euro crises made an impact on several European countries (created by their own different circumstances and weaknesses of these European government policies) but undoubtedly, one country, that can be held responsible for the massive crisis that eventually affected many other European countries is none other than Greece. The Gross Domestic Growth (GDP) rate for the year 2010 clearly shows the condition of Greece [3].

HCTL Open International Journal of Technology Innovations and Research (IJTIR)
http://ijtir.hctl.org
Volume 16, July 2015
e-ISSN: 2321-1814, ISBN (Print): 978-1-943730-43-8

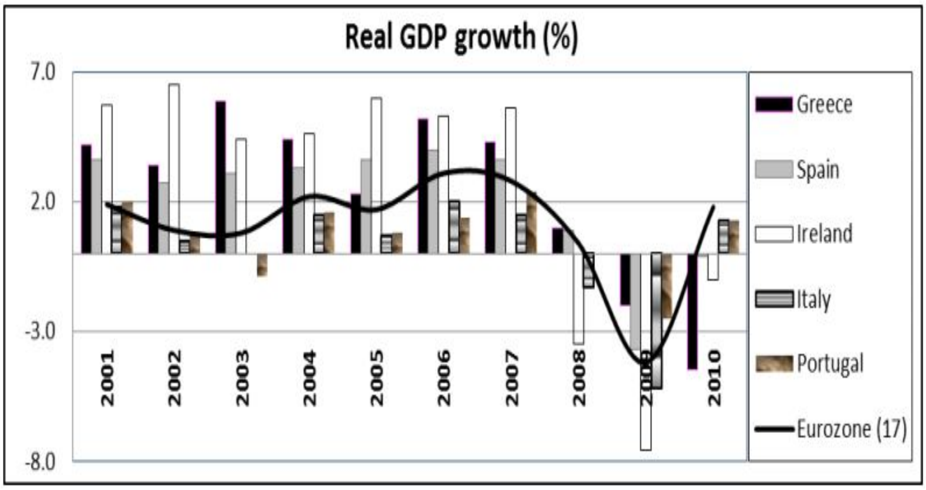

Fig: 1 GDP growth rate (%) from 2001-2010

Greece

Greece set the tone for disaster when it lied about its circumstances and lived beyond the rules and regulations which were laid down by the European Union in Maastricht Treaty. In the early mid-2000s, Greece's economy was one of the fastest growing in the Euro Zone and was associated with a large amount of surplus wealth [4]. As the world economy was hit by the global financial crisis in the late 2008, Greece was hit especially hard, because its main industries, those of tourism and shipping were extremely sensitive to changes in the ongoing business and fluctuations resulting from them.

Also the government increased its commitments to public workers in the form of extremely generous wage and pension benefits, with the former doubling in real terms over 10 years which in turn derailed the already crippling situation. Jacob Kirkegaard, of the Peterson Institute for International Economics in Washington says “Greece is fundamentally a corrupt, dysfunctional government that is unable to raise enough tax revenue to pay for all of its expenses.” Greece intentionally ignored internationally agreed standards sidestepping best practice which allowed them to mask their deficit and debt levels through a combination of methods, including inconsistent accounting and use of complex currency. The complex structures were designed by prominent U.S. investment banks, who received some reward in return for their services which helped hide the economic truth of Greece’s currency.

Statistics have proved that public sector wages rose 50% between 1999 and 2007, far faster than in most other Euro Zone countries [5]. The government also ran up big debts paying for the 2004 Athens Olympics. As the money flowed out of the government's hands, its income was hit by massive tax evasion. So, after years of overspending, its budget deficit (the difference between spending and income) spiralled out of control. Moreover, much of the borrowing was concealed by the Greece government. When the global financial downturn hit, bringing Greece's hidden borrowings to light, the country was ill-prepared to cope up. Debt levels hit so badly that the country was no longer able to repay its loans, and was forced to ask for help from its European partners and the IMF in the form of massive loans of 110 billion Euros in May 2010 and again 130 billion Euros in 2012 [6].

Why Greece crises mattered for the rest of Europe?

It was speculated that if Greece's economy continues to contract sharply, then it may not be able to cut its overspending, making it impossible to repay its debts eventually making the investors increasingly nervous about the likelihood of investing in other highly-indebted nations, such as Italy, or those with poor economic conditions, such as Spain, Portugal to repay their debts or even continue sustaining inside the Euro. If investors stop buying bonds issued by third party, then other governments in turn will not be able to repay their creditors creating a potentially disastrous vicious circle. To prevent this risk, European leaders agreed on a 700bn Euro firewall to protect the rest of the Euro Zone from a full-blown Greek default. The maximum debt allowed by the European Union was only 60 percent of gross domestic product.

Conclusion and Suggestions

The Euro zone crisis hit many European countries but Greece was the main driving force for bringing the crisis. The solution and suggestions which economists found practical and reliable to bring Greece out of the crisis was the recommendations to countries to follow the austerity policy. This would prevent the countries from indulging in more spending so that they do not end up in more borrowings. Germany currently being the strongest in the Euro Zone and also being the key player was and is expected to continue to help by giving borrowings to affected countries. The above mentioned best case scenario was expected to come true and from the lessons learnt during the desperate economic and financial crisis of Europe is that a unified and stable Euro Zone will emerge that will be based on the strength of a single joint currency. But for this to happen all governments will have to agree to strict borrowing rules and everyone including the public will have to agree to bank bailouts. Also a fully integrated political as well as monetary union will prevent the local filthy politics as well as result in a stronger integrated government. This will also lead to greater confidence, providing stability in business and preventing devaluation of the currency in any form. But risk as always exists in the form of inflation that can lead to further fall of the Euro. Also the wages may not be able to keep up with the increase in inflation and the whole economy will have to face the outcome of the existing crisis for many years to come. Not only that what if the government does not prove reliable and does not stop its spendthrift ways even after a bailout. This will surely lead to a major collapse. Finally, a mechanism called European stability mechanism was enacted which acted as the most promising solution. Started in February 2011, it was a kind of bailout fund initiated by the Euro Zone finance ministers. The policy stated that 500 billion Euros would be distributed to the affected countries as debt as on when they apply for loans. Most of the money comes from Germany and France. This sounded safe, but to come out of the pit and restore competitiveness and effective fiscal structure, sustained and deep structural reforms are required to be implemented by the government of all these involved nations without breaking any rules and guidelines.

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