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Greek Crisis 2010: the Collapse of the European Monetary Union?

By

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Abbreviations

BEPG	– Board Economic Policy Guidelines
bn	– billion
EC	– European Community
ECB	– European Central Bank
ECOFIN	– Council for Economic and Financial Affairs
ECU	– European Currency Unit
EEC	– European Economic Community
EFC	– Economic and Financial Committee
EMI	– European Monetary Institution
EMS	– European Monetary System
EMU	– European Monetary Union
ERM	– Exchange Rate Mechanism
EU	– European Union
IMF	– International Monetary Fund
LMU	– Latin Monetary Union
OECD	– Organization for Economic Cooperation and Development
SCU	– Scandinavian Currency Union
SEA	– Single European Act
TEU	– Treaty on European Union

Introduction

The year 2008 was a period of global economic downturn. Prices of oil, food went up, inflation and unemployment increased. The credit crisis provoked the bankruptcy of banks of different size. USA, Japan were hurt by the crisis. Eurozone suffered as well. Greece has the worst situation among today's 17 members of the EMU. Mass media, print media and the Internet are filled with the news about what's happening in Greece, with its economy and, of course, with the EU response. Since 1981 Greece is a part of the European Community and in 2001 it adopted the euro and joined the European Monetary Union.

The relevance of the topic "Greece Crisis: the Collapse of the European Monetary Union?" explains by the reason that today many people in Greece, in the EU and people of the global community observe the situation and think of further workability of the euro system. This paper is written with an attempt to think about what can happen to one of the world's biggest markets and the euro as world's reserve currency.

The main objectives of this work are:

1. To review the causes of the current crisis and its effect on shipping and tourism of Greece;
2. To analyze the steps that has been taken to meet the crisis;
3. To analyze whether those steps/plans will have a positive effect on Greek economy and can they really strengthen it;
4. To find an answer to the question if the Greek debt crisis can cause the collapse of the EMU.

The work is based on the review of the researches that have been already done by scholars from different states and with a various opinions about this topic. Also paper contains the analysis of the data concerning the economic situation in Greece.

Chapter one gives a definition of what it was used to call a monetary union, as well the mechanisms according to which it functions and aims to which it servers. This explains the principles of any monetary union. As well this chapter gives two historic examples of monetary unions of the 19th century. One of them is Latin Monetary Union and another is the Scandinavian Currency Unions. They show that the today EMU is not the first notion of European states to establish a single currency. Moreover, they met challenges and finally collapsed. And this makes think if the EMU follows their example.

Monetarism theory is explained in the second chapter. It is the theory that can explain the dept crisis, unemployment etc. It was included as a part of the work to give an idea how the state may act in order to cover the deficit and raise the economy.

Chapter three is a historical part on how the European Monetary Union appeared. This chapter gives an overview of what has been done by the European states since after the Second World War and the creation of the Bretton Woods system till the adoption of the Treaty on European Union in 1992 and the introduction of the euro in 1999. As well, this chapter explains the policy-making in the EMU.

Chapter four contains an analysis of the accumulation of the crisis, and its outbreak. The causes that had such an impact on the scale of the crisis are also revised in this part. In order to understand the influence of the crisis this chapter analyzes the situation in shipping and tourism industries as two main sectors of Greek economy; and the consequences of the Greek debt crisis for Greece and the EMU.

In the following chapter five the Greek austerity and the IMF/EU rescue package plans are investigated. It talks about what has Greece done to meet the crisis, to reduce the budget deficit and to stabilize economy. As being a part of the EU and EMU Greece formally asked for EU help. The EU and IMF designed a bilateral loan for Greece that is worth about 110 billion of euros.

The effect of the crisis on Greek economy will be investigated in a way that in spite of the economic decline, loose of trustworthy and skepticism of other EU members, Greece will rise its economy and the crisis will have a positive effect both Greece and the EMU.

One of important goals of EU member states is to join the EMU. Greek government budget deficit was higher than the Masstricht criteria required, government misreported that allowed Greece to adopt the euro and gave an excess to the low interest rates credits. This chain led to the current debt crisis and now Greece has to follow the austerity plan, asks for help of IMF and the EU.

Chapter 1: Definition and examples of a monetary union

1.1 Monetary union – definition, mechanisms, and aims

For further exploring of the EMU, this chapter gives a description that monetary unions differs in terms of institutional division, in political terms; and always their aims are to facilitate trade relations and to reduce transaction costs.

Monetary union is a unification of two or more sovereign states under common currency or its equivalents such as gold or silver. The main features of a monetary union are the common currency printed by the common central bank and the fixed exchanged rates. This is a contrast to the national currency with its individual central bank and floating exchange rate. In the strictest sense of the term, monetary union means complete abandonment of separate national currencies and full centralization of monetary authority in a single joint institution (Cohen "Monetary Unions").

The institutional division of monetary union can be of two kinds. First is the issuing of currency, and second is the management of decisions. Issuing of currency implies that currencies may still be issued by national governments and exchange rate ties them together. As an alternative variant currencies may be replaced by the currency of the larger and stronger partner. The management of decisions states that national governments may continue to exercise the function of a monetary authority to a certain extent and they may not delegate this role to a joint institution, but rather to one of the partners – the largest and the strongest one – as e.g. the United States.

In political terms monetary unions are divided into two categories. It depends on whether the national sovereignty in terms of monetary policy is shared or surrendered. Unions with a joint currency base or with an exchange rate base have effective monetary authority. They have a form of equal alliances or partnerships. In contrast, the structure of unions with that are created on a base of one partner-leader causes the emergence of hierarchy and subordination.

The greatest attraction of a monetary union is that it reduces transaction costs as compared with a collection of separate national currencies (Cohen “Monetary Unions”). Transaction costs cheapen because now they don’t incur the expenses of currency conversions or hedging against exchange risk.

However, disadvantages must also be considered by governments. First, countries-partners loose control over the money supply and exchange rate. These are the instruments to resist domestic and external disturbances and shocks. Second, countries-partners loose their exclusive capacity to print money with an aim to increase public spending. Such an exclusive right is also known as seigniorage. This is an alternative source of revenue beyond what can be raised by governments through taxes and borrowing from financial markets.

The type of a monetary union determines the importance of losses mentioned above. In unions with parity type authority is pooled. National governments delegate monetary control to a joint institution. The control is shared and collectively managed by all members of a union. Therefore, each partner looses and gains simultaneously. In unions with a leader-partner individual governments loose a lot of their freedom. In this case looses will be delivered in ‘one pair of hands’. Subordinated partners can resist some measures of seigniorage, however, only with a compliance of a leader.

The ultimate goal of a monetary union is to create a single market among its members. It facilitates trade relations, reduces transactions costs. As well it establishes the unimpeded flow of goods, services, labor and capital among them.

In 19th century the idea of a monetary union appeared and it was widely promoted especially in Europe. At that time many national currencies were already fixed to each other by the gold standard.

1.2 Latin Monetary Union

Latin Monetary Union is an example of monetary unification of 19 century, where France was the main inspirer and executive; and which had a one-to-one exchange rate.

By 1890s France, Belgium, Switzerland and Italy had intense trade relations, because of their close geographical location. The chamber of commerce favored the adoption of the gold standard and monetary unification (Einaudi 285), however bankers did not support this notion of monetary unification, and they did not want changes to be brought to existed monetary standards. It was France and Napoleon III as its emperor who wanted to expand the area of French influence. French side stated that this Union[*] had to unite all civilized nations and they should adopt a common coinage. There were both political and economic factors to establish the LMU.

The French economist and politician Félix Esquirou de Parieu directed the French policy towards monetary unification and embodied its most liberal character (Einaudi 286). French government insisted on that the LMU must be considered in a larger prospective, not rather than just a uniform circulation of money through Europe. Therefore, in 1865 France, Belgium, Italy and Switzerland established a monetary union based on French franc. In 1867 Parieu proposed to introduce a new unit a 'Europe' that was equal to 10-franc unit. The French gold coins constituted the largest part of gold circulation in Europe. But the Monetary Convention of December 25, 1865 did not really create a union; rather it was the Latin European coinage agreement. The union was introduced a single unit of account. There was a fixed one-to-one exchange rate. The idea was that countries would have identical coinage made of silver or gold (GoldCoin.org). It implied that faces and names of coins in each country would not change, but their weight would be the same, e.g. 5 French francs were equal 5 Italian liras. Nations did not deliberated their sovereignty to a unite institution. It was restricted only in some parts in terms of overvalued divisionary silver coins and by countries' obligation to respect issued by other members. Union was not managed by any administrative institution. Unlike European Monetary

[*] In this chapter the word Union relates to the LMU

Union today there was no central bank or any network of central banks, “no penalties for over-issuing currency or suspending the convertibility of their paper currency in gold and silver” (Einaudi 286).

The LMU scored some early success and proved popularity with many southern and central European states (Einaudi 287). As in 1866 France offered any state to join the Union, simply it had to observe the rules of the LMU. Thus, Greece and Bulgaria joined the LMU in 1867 and some states (Romania, Austria, Spain, Finland, Venezuela, Serbia, Montenegro, San Marino and Vatican) did not officially join the LMU, but issued currency following the conventions. Public sector of economy in these countries was poor; therefore, they wanted to facilitate their international trade, to improve and to strengthen the standard of their internal currency, to acquire monetary credibility. As well it gave them an access to international financial markets.

Of course, there were political motives explaining why states joined the LMU and directly appealed to France. Greece upraised against the Turkish occupation in Crete, therefore it made an application when it needed French support. Vatican applied the LMU in order to receive protection against Italy. And Italy entered the Union because it needed both political and financial support from France to complete the unification of the state.

Unlike the states mentioned above neither Great Britain nor Prussia wanted to join the LMU. They did not want to be in a subordinate position; as well they didn’t need a political protection of France. Actually, the name LMU was given by the British press. Thus, it showed the impossibility of extension to the northern Europe (Einaudi 284).

In spite the first success of the LMU it did not continued to exist for a long time. And there were some reasons for its failure. Einaudi (2000) argues that neither the disturbance of the price of silver nor the Franco-Prussian war in 1870 were the causes of failure of this union. Rather it was the conflict among interest groups. They paralyzed policies of France and those regulated the work of the LMU. Struggles inside the interest groups led to the split of governments. As a consequence it provoked the misbalance among political powers. The balance shifted to the

conservative side. By comparing the popularity of the LMU in northern and southern member states, it can be concluded that in southern part the LMU was popular, while in the northern it failed.

1.3 Scandinavian Currency Union

Scandinavian Currency Union is the second example of the European states' monetary unification that adopted the gold standard and abandoned it at the beginning of the First World War.

The SCU was more successful than the LMU and functioned during forty eight years. The SCU was established on May 27, 1873 by Sweden and Denmark. They agreed that it would be based on gold. It was supposed that Norway would enter the Union[*] in 1873 as well. However, the Norwegian parliament rejected this opportunity. Only in 1875 after the SCU adopted the gold standard Norway joined the Union. By the Scandinavian Monetary Commission that signed the treaty in 1872 it was written that "three countries introduce the decimal system and adopt a common unit of currency" (Bergman 365). The treaty defined the value of a new unite in terms of gold. According to the treaty before the end of 1881 countries should replace their national coins by the new unit. The treaty fixed the eight-year transition period and contained a note on the exit case.

Countries were allowed to mint not only golden coins, but bronze and silver ones as well. Such coins were used as subsidiaries or so called tokens. Countries agreed that they would accept both golden coins and tokens, minted by others. And the treaty of the SCU regulated the weight and denomination of tokens. The disadvantage was that the treaty did not regulate the reserve amount of tokens, so countries could mint as much as they were needed. Fixed rates between tokens and golden coins prohibited overissuing of national currencies.

Control over the monetary policy and states' sovereignty was not delivered to a common institution. And the gold standard regulated the monetary policy within the SCU. In order to

[*] In this chapter the Union relates to the SCU

arrange the monetary policy countries agreed to share information on activities that were taken by monetary authorities within these countries.

Until 1894 the central banks of each member accepted the bank notes of each other by their nominal price. Such measure was not indicated in the SCU agreement. And formally it was done in 1894 by Norway and Sweden. Denmark joined in 1901.

In spite of the common currency the members of the SCU had separate exchange rates of the currency on the markets of international exchange. The currency union could be created by the gold standard itself, thus the exchange rate bands of a single currency should be smaller against other gold-standard-base currencies. Comparing the exchange rates among members of the SCU and countries outside the SCU, it was found that the exchange rates within the Union were lower than the non-Scandinavian exchange rates. For example, the Swedish/German mark exchange rate was twice as volatile as the Swedish/Danish exchange rate (Bergman 366).

The SCU treaty concerned the establishment of the common currency union and did not contain notes on international relations and trade in particular.

The trade among the SCU members was small and unimportant, while the trade with the German states and the UK was significant. Paradoxically, but the intra-Scandinavian trade diminished during the SCU existence. As well the movement of labor force was small within the SCU. And the growth of populations differed significantly. In Norway and Denmark it was constant, while in Sweden it swayed considerably. The economic structures of the countries differed from each other. In Sweden and Denmark the agricultural sector dominated, while in Norway it was the sector of service.

In 1905 Norway and Sweden broke with their political relations, as a result the central bank of Sweden nullified the SCU agreement of 1885. However, the acceptance of each other’s drafts continued, but no longer necessarily at par (Bergman 367). Norway, Sweden and Denmark abandoned the gold standard at the beginning of the First World War. And this meant that three countries abandoned the agreement simultaneously.

Summarizing, it must be highlighted that in spite that the SCU sometimes is called as the most successful European currency union, there were important and real reasons why it collapsed. They were the different trade patterns, economic structures and population growth.

Chapter 2: Monetarism theory

Further this chapter discusses that monetarism theory is a theory that explains how the amount of money influences the price level, revenues, production and unemployment. The main idea is that monetary policy is a basic instrument to regulate income.

According to the definition of the monetary union its main point is that states unite under single currency. In order to understand processes those are dependent on the currency, its circulation, supply and demand, I suggest review the monetarism theory. It also presents mechanism and instruments effecting and explaining processes related to the currency.

Since 1930s till 1970s Keynesian theory was predominant in economy and policy-making of some countries. In 1970s after the simultaneous growth of unemployment and price level, that Keynesian theory was not able any more to explain these processes. The Chicago school of economics that represented the neoclassical school of thought established the monetary theory. It was described by Milton Friedman and Anna Schwartz in "A Monetary History of the United States, 1867-1960". According to Phillip Cagan (1987) monetarism is a view that variation in money supply has major influence on national output in the short-run and price level over longer periods and that objectives of monetary policy are best met by targeting the growth of the money supply. In short it means that monetarism is an economic policy that involves controlling the amount of money that is available and in use in a country at one time and this is the chief method of stabilizing the economy.

In principle the monetarism theory is based on the 16th century theory of mercantilism. The main point of mercantilism is that it views that the country welfare depends not on the production, but relevance of the amount of exporting goods over the amount of importing and accumulation of capital.

The term monetarism was introduced by Karl Brunner in 1968. Usually it associates with the Chicago school of economics that states that the total revenue has first and foremost influence on change of money supply. Milton Friedman established a theory of monetarism that defines the

level of income and the cyclic theory. The main idea of the theory is about the influence of money supply on the price level. According to Friedman's theory (Patinkin 1972:885) money matters on the price dynamics and just the money supply, not interest rates, influences the market of money or conditions to obtain a credit. Friedman states that the control of interest rates by commercial banks is not a useful or effective instrument of monetary policy (Money, credit, and banking 32).

For monetarists capital is the total sum of cash assets. Change in price is the main factor affecting the amount of cash reserve and other financial assets. As far as the dynamics of money supply has first and foremost significance to explain the fluctuation of production, the conclusion is that the monetary policy is the most effective instrument of income regulation.

One of the key points of monetarism to explain economic cycle says that money plays an important role in the change of an active income, employment and common level of prices. It states that there is a correlation between growth rate of money supply and nominal income. In a case of rapid growth of money supply, the nominal income grows rapidly as well, and vice versa. The alteration of money supply influences price level and the amount of production. In this case monetarism functions to manage money demand and thus to manage economic process through it. Monetarists maintain that capitalist economy is a stable system and it can reach equilibrium by self-regulation. They created a system of economic cycle where the change of money supply plays a determinant role.

The size of money demand is a result of optimization of different alternative investments in capital and depends on existing or expecting prices of different assets. In case when sizes of marginal revenues of all practicable investments are equal then the optimum reaches. In case when sizes of marginal revenues are not equal, the structure of assets changes. The part of assets which are able to return the bigger interest increases or the part of less profitable assets reduces. An important determinant of money demand in this system is the size of nominal income that depends on money demand and supply. In order to avoid deadlock it is assumed that the size of

money supply must be determined over and above the system. Monetarism theory says that ex ante money supply* entirely and instantly accommodates to the amount in demand. They also make a conclusion that the change in nominal income can be made by the change of money supply. According to Friedman (Patinkin 1972:892) the alteration of nominal quantity of money affects on the size of production, unemployment in short-term and on price in long-term. He points out the constant dependence between the change of money supply and the cyclical fluctuation of economic activity.

Ramaa Vasudevan ("Dollar and Sense" Sept/Oct 2006) writes that the wage defines correlation between demand and supply on the market of labor. Therefore, in order to influence on the total amount of production the money demand adjusts to its supply. The size of the wage depends on money demand and supply as well. The employment is determined by the level of actual wage and absolute price level does not depend on money supply. The full employment can be achieved only by reducing the wage.

In conclusion, according to monetarists any economic process depends on fluctuation of money supply. Any divergence from equilibrium can be removed by the adjustment between money demand and supply.

* Ex ante money supply = supposed money supply

Chapter 3: Historical background and policy-making of the EMU

After the Second World War six countries established ECSC by the treaty of Paris in 1951. One of their aims was the reconstruction of the destroyed regions. Step by step the cooperation became deeper and touched different spheres. And as a consequence, today there is the EU and one of its integral parts is the European Economic and Monetary Union. Following chapters contain history of creation of the EMU (4.1 – 4.4) and one more chapter (4.5) explains how the policy-making happens in the EMU. **Table 1** is the brief summary of main dates and reports that relate to the creation of the EMU.

Table 1. Main steps toward the EMU

1950 · 1960 · 1970 · 1980 · 1990 · 2000

1	2	3	4
from the Treaty of Rome to the Werner Report: 1957 to 1970	from the Werner Report to the European Monetary System (EMS): 1970 to 1979	from the start of EMS to Maastricht: 1979 to 1991	from Maastricht to the euro and the euro area: 1991 to 1999

Source: European Commission, Publication Office. *One Currency for One Europe:The road to the Euro*. Belgium, 2007 p.4

3.1 Bretton Woods system

After the Second World War US dollar had a very strong power and uniqueness in international trade. The market economies of North America, Europe and Japan were founded on the Bretton Woods system. This was the transition step of European countries toward their own common currency.

The system was established in 1944 in a New Hampshire town, USA. It was a mechanism to exchange currencies on the international basis. As well it led to the creation of the International Monetary Fund and the World Bank. This was an attempt to create the system of free international trade. It should assist as well in the postwar reconstruction. Participants agreed that they would fixe exchange rate mechanism based on the US dollar. American politicians, meanwhile, assured the rest of the world that its currency was dependable by linking the U.S.

dollar to gold; $1 equaled 35 oz. of bullion (Stephey 2008). However, Europeans assumed that Europe's construction could be securely based on achieving a customs union and a common market allowing the free movement of goods, services, people and capital. These pointes they indicated in the treaty of Rome

The Bretton Woods system came under pressure in the late 1960s and early 1970s. It happened because policies taken by the United States diverged from policies of other countries. The United States faced rising unemployment and an increasing deficit at that time their monetary policy became more expansionary. Therefore, the tension between dollar and other currencies led to the collapse of the system in 1973.

EEC authorities continued their policy orientation toward own single monetary policy and currency. As well they assumed it as a way to enhance Europe's role in the world monetary system. Fixed intra-European exchange rates were also thought to be important for promoting trade in goods and services and capital flows within Europe.

3.2 Hague summit and Werner report

The creation of the purely European monetary system started in 1969 at Hague summit. It was the first significant steps out of three to establish the Euro.

At The Hague summit the Barre Report proposed greater economic coordination. In addition the Government communiqué announced the EMU as one of goals. It stated 'the development of monetary cooperation should be based on the harmonization of economic policies' (The Final Communiqué of the Conference 1970: point 8). The idea of harmonization was unique and significant, because it emphasized that before unification different economies must have the same level of development.

Another report by Pierre Werner, the Prime Minister of Luxembourg, expressed steps on how the EMU could be achieved by 1980. It suggested the three-stage process within ten years. The final objectives would be next:

- “the Community currencies will be assured of total and irreversible mutual convertibility free from fluctuations in rates and with immutable parity rates, or preferably they will be replaced by a sole Community currency;
- The creation of liquidity throughout the area and monetary and credit policy will be centralized;
- Monetary policy in relation to the outside world will be within the jurisdiction of the Community” (Werner report Chapter 3), etc.

In order to achieve objective the report called for closer coordination in several terms of economic policy: interest rates, reserves, frameworks for national budgetary policies. At time when it was adopted the Council restricted the fluctuation between dollar and its currencies to 0.6 per cent (‘the tunnel’). It caused the pressure on banks and devaluation of the dollar. Therefore, European system of exchange rates was set up in order to narrow the gap between strong and weak currencies. The limit between currencies was up to 2.25 per cent (‘the snake’). Thus the metaphor of the ‘snake in the tunnel’ appeared. It was an attempt of the exchange rate band for the Economic and Monetary Union to peg European currencies to one another. This flexible system provided currency stability and ability for central banks to intervene if needed. By 1975 the ‘snake’ collapsed because the international conditions were not right, the Werner plan was simple and insufficient national political will.

3.3 Exchange rate mechanism and Delors report

In 1978 the international economic situation improved, thus the EEC members made next step to create exchange rate system. It was made in 1979. Eight of the nine members of the European Community, all except for Great Britain, participated in the Exchange Rate Mechanism. At that time differences in inflation rates across members of the ERM were up to 10 percentage points. Inflation rate differentials narrowed across Europe by the mid 1980s and

by 1987 most capital controls were lifted (Klein 6). The Single European Act called for removing all internal barriers to trade, capital movements, and labor migration within Europe by the end of 1992. The SEA was another step toward European economic integration, which began with the Treaty of Rome.

Further step was made after the Hanover summit of 1988 where the president of the Commission Jaques Delors and the central banks governors submitted a report in April 1989. This Delors report proposed the principle features of monetary union were "the assurance of total and irreversible convertibility of currencies; the complete liberalization of capital transactions and full integration of banking and other financial markets; and the elimination of margins of fluctuation and the irrevocable locking of exchange rate parities" (Delors report 14). According to the Report[*] the transition to a single currency must be made in three stages. **Table2** presents in short these three stages and what should be done at each of them.

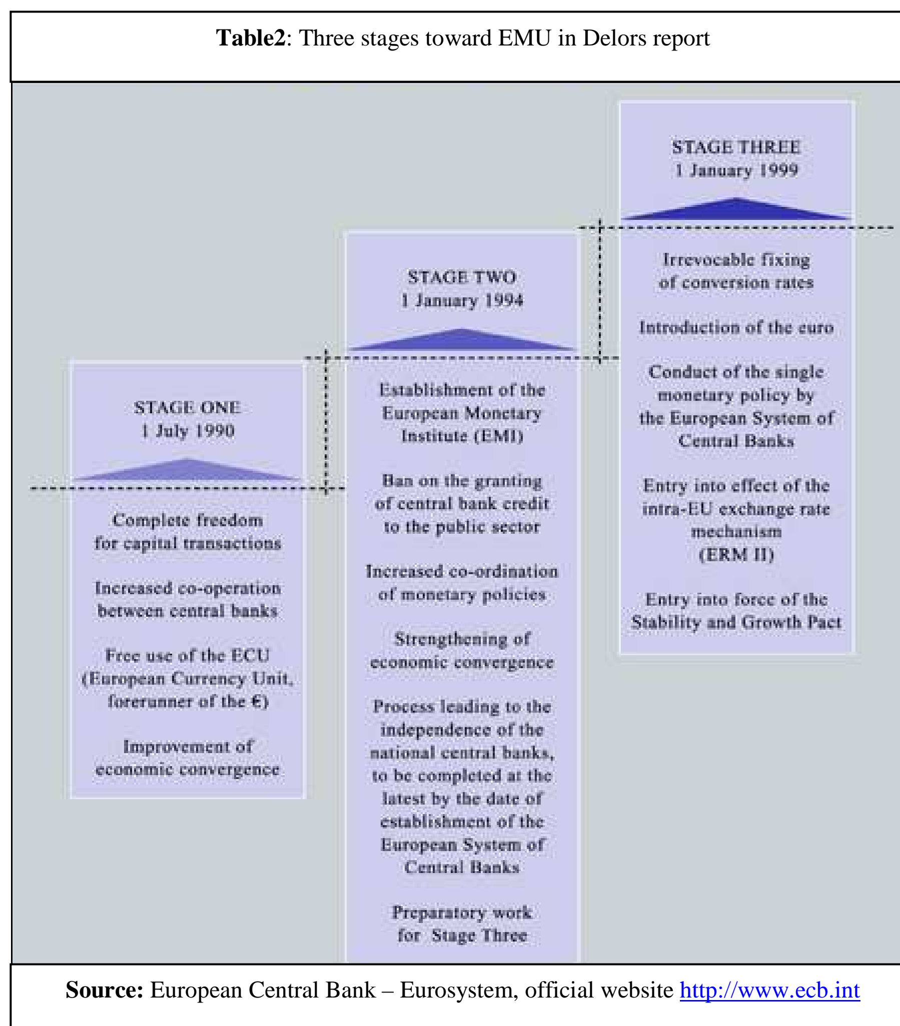
The first stage aimed "to have all EC states as full members of the ERM …to create a system of discipline for the EMS currencies, increase cooperation of monetary policies and bolster the ECU" (Archer 86). This first stage was the beginning of the process of creating economic and monetary union. This stage implied the final step to complete the creation of the internal market and to reduce the economic misbalance and differences among member states. At this stage Commission should complete the removal of fiscal, technical and physical barriers.

It said that the second stage in Delors report was that it might come into force only when the new legal basis would be adopted and legally binding. At this stage all the basic and necessary institutions and structures should be set up. The institutional framework would take over operational functions, serve as the centre for monitoring and analyzing macroeconomic developments and promote a process of common decision-making, with certain operational decisions taken by majority vote (Delors report 33). The second stage involved narrowing of

[*] Delors report

exchange rate bands and the establishment of institutions of the EMU, which would supervise the domestic monetary policies.

Table2: Three stages toward EMU in Delors report



Source: European Central Bank – Eurosystem, official website http://www.ecb.int

The third stage assumed the "commence with the move to irrevocably locked exchange rates and the attribution to Community institutions of the full monetary and economic competences" (Delors report 35). This stage would establish a European System of Central Banks to replace national central banks and replace national currencies with a single European currency. The Maastricht Treaty, signed at the end of 1991, set up a timetable for this process, with stage three starting no later than January 1, 1999.

However during next year the timetable planned at Maastricht was infracted and the probability that European single currency would ever become a reality was questionable. In June 1992 Danish voted against ratification of the Maastricht treaty, and they expressed the "growing

public skepticism about the desirability of a common currency" (Klein 6), that led to the speculative attacks of European currency markets. Great Britain and Italy dropped out of the ERM in September 1992. Sweden and Finland, which had been shadowing the deutsche mark in hope of eventually joining the EMS, were forced to devalue later that autumn. And in 1993 France was able to retain its membership in the ERM only through a widening of the bands from ±2.25 percent around the central parity to ±15 percent (Klein 6). In spite of these economic events political support for European Monetary Union among the leaders of Europe remained strong. This support allowed staying on the way toward the completion of the Maastricht criteria and fostering the efforts to rich them.

3.4 TEU and Maastricht convergence criteria

The EC states produced the Treaty on European Union in 1991 which consisted of four chapters and number of protocols on the establishment of and economic and monetary union, including a single currency. Title VI of the TEU is devoted toward the regulations and main principles of the economic and monetary union.

According to article 102a of TEU states that "Member States and the Community shall act in accordance with the principle of an open market economy with free competition, favoring an efficient allocation of resources". Article 103 (1) details that "Member States shall regard their economic policies as a matter of common concern and shall coordinate them within the Council" and article 103 (2) says that the Council must "formulate a draft for the broad guidelines of the economic policies of the Member States and of the Community". Thus the Treaty[*] provides a balance between strict qualifications and the need to press ahead to move the single currency and monetary union without a possibility to reverse.

The TEU contains and states the precise convergence criteria also called as Maastricht convergence criteria in Article 109j of Title VI. According to this article "the Commission and the EMI shall report to the Council on the progress made in the fulfillment by the Member States

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[*] Treaty on European Union

of their obligations regarding the achievement of economic and monetary union". The Maastricht convergence criteria were created with an aim to ensure that the economies of member states were appropriately prepared for the adoption of the single currency. They provided a common basic level for the stability, strength and sustainability of public finances. It was made in order to let them be ready for changes in economic policy convergence and elasticity for economic shocks. These criteria were invented to find out if a member state could manage its economy. Five main criteria were worked out.

First of all, states should have no more than 1.5 per cent inflation during a period of one year comparing to the rates of three states with the lowest inflation. Second, the budget deficit of the state should not exceed 3 per cent of its gross domestic product. Third, the government debt must be less or equal 60 per cent of country's GDP. Fourth, the long-term interest rate should not be more than 2 per cent for at least last two years comparing to three states with the best performing of price stability. And the fifth was the criteria that the country should stay in the Exchange Rate Mechanism for two years. **Table 3** summarizes the Maastricht convergence criteria, explains how they should be measured.

At the end of February 1998, when European governments released their official results for 1997, eleven members of the European Union met the fiscal and inflation criteria required for participation in the European Monetary Union at its initial stage. All had inflation below the required rate which is about 2.9 percent for 1997 (Klein 8). All also had fiscal deficits of less than 3 percent of GDP. Interestingly, the deficit ratios of the three countries that were initially the source of the greatest concern, Italy, Spain, and Portugal were each lower than the 2.7 percent ratio recorded by Germany. Sweden, the United Kingdom, and Denmark are choosing not to join EMU at this stage. Greece is the only country that desired membership in EMU but was precluded from this at that time with other eleven countries because of its failure to meet the economic criteria. However, it joined the EMU later, but with violation of some Maastricht

convergence criteria. An interesting fact is that Germany was the first state that violated the Maastricht criteria, but comparing to Greek economy it was more stable and trustable.

Table3: Maastricht convergence criteria.

What is measured	How it is measured	Convergence criteria
Price stability	Harmonised consumer price inflation rate	Not more than 1.5 percentage points above the rate of the three best performing Member States
Sound public finances	Government deficit as % of GDP	Reference value: not more than 3 %
Sustainable public finances	Government debt as % of GDP	Reference value: Not more than 60 %
Durability of convergence	Long-term interest rate	Not more than 2 percentage points above the rate of the three best performing Member States in terms of price stability
Exchange rate stability	Deviation from a central rate	Participation in ERM for two years without severe tensions

Source: *One Currency for One Europe: the Road to the Euro.* Belgium: European Communities, 2007

As it was written by Christian N. Chabot, the euro has evolved as an essential step toward the ultimate goal of "ever closer" political integration first outlined in the 1958 Treaty of Rome (37). Comparing to other currencies euro is quite new currency created by the European Union member states. This is the currency that became legal tender on January 1, 1999. By 2002 the euro replaced national currency in Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, Denmark, Portugal and Spain. The last enlargement of the Eurozone happened in January 1, 2011 when Estonia became a part of the EMU and adopted the euro.

3.5 Policy-making in the EMU

For now the economic and monetary policies are presented on the supranational level. Maastricht treaty contains the main economic and monetary framework, goals and fundamental principles of economic governance. First of all it includes the price stability as primary objective of the monetary policy. Second principle is the independence of the European Central Bank. And the third principle states for the sustainable growth of the public finances.

Unlike monetary policy, the fiscal policy remains a national competence. But the EU puts different constraints on the fiscal policies of its member states at different levels. It is done in order to coordinate the policies of the states and the need to support public finances. The EU exercises the coordination through the Board Economic Policy Guidelines (BEPG) and other coordination procedures. The economic policy became a matter of common concern and it is coordinated through the ECOFIN. Thus the economic policy includes government tax and expenditure policies. According to the TEU, all members of the Union are protected against becoming responsible for financial liabilities of other member states. That is the case of no bail-out situation.

There are several EU procedures that are relevant to the coordination and conduct the fiscal policy. These are the Mutual Surveillance Procedure and the Excessive Deficit Procedure lunched by the Lisbon Treaty. One more is the Stability and Growth Pact established by the Council. The multilateral surveillance procedure includes the possibility of making confidential or public assessments of the policies of individual member states and to give confidential or public recommendations to the governments (von Hagen 5). The BEPG consolidate various policy coordination processes at the level of the EU. As well it acts as a reference for the multilateral surveillance procedure.

The European Council decides on the proposals of the European Commission which are done on the basis of the BEPG recommendations. The European Council decides on the recommendations of the ECOFIN as well.

The process of monitoring public finances is set up by the Excessive Deficit Procedure. And member states have to ensure that they remain sustainable in the sphere of public finances. Also it includes a warrant that the members of the EMU will implement appropriate measures in the sphere, thus enabling to fulfill their obligations to maintain sustainable finances. However, “the practical meaning of this obligation is vague” (von Hagen 5) formally members can be asked to change their institutions in case if this enables them to maintain stable public finances. The EU

common policies and the monetary union can function without coordination, while sound public finances are necessary for the EMU to function properly (von Hagen 5). And there are no penalties for governments if they fail to adhere to coordination. In contrast, maintaining stability is required; therefore the EMU states can be penalized.

The monetary policy procedure is the next concern. In 1998, the Government Council of the ECB adopted an explicit monetary policy strategy (Parpademos 26). It contains several key elements.

First is that the ECB has to keep price stability and establish a 'quantitative definition' of price stability and the policy aim. This provides both a firm anchor for inflation expectations in the euro area and a yardstick for holding the Bank accountability (Papademos 2006:27). Second is that the strategy is forward-looking and has medium-term orientation. Such orientation allows for a gradual response to some economic shocks. The main notion as that the policy should be designed according to circumstances. Its medium-term orientation also implies that the single monetary policy can avoid unnecessary high opt-out volatility in the economy, without compromising price stability (Papademos 27).

Another element conducts analysis and explains policy decisions in two perspectives: economic and monetary. This broadly based framework ensures that the Governing Council arrives at a robust overall assessment of the current economic situation and the associated risks to price stability (Papademos 27).

As it was mentioned previously, member states coordinate their economic policies at the level of the EU. The Council for Economic and Financial Affairs (ECOFIN) is the relevant institution for discussion and decision about spending, taxations and government deficits. European Commission and the Economic and Financial Committee (EFC) serve as secretariats to the Council of Ministers. The Council, according to the TEU, adopts recommendations and policy guidelines by majority voting on a proposal of the European Commission.

Another body is the Euro Group that was established by the European Council in 1997. It consists of financial ministers of the member states of the euro area. It has no legislative power. The main role of the Group is to assess the economic situation and to discuss the policy issues for the Eurozone. It meets in coordination with ECOFIN meetings (von Hagen 7). At the beginning the presidency in the Group changed annually. But since the Lisbon Treaty came into force the period was extended to 2.5 years. Also the Treaty[*] determines that both the European Commission and the ECB will take part in meetings of the Group.

The Commission has a right to provide political agenda for the meetings of the Council. As well it has a right to provide analysis for multilateral surveillance. The EFC is an advisory body. It consists of representatives of national banks and administrations, two representatives from the ECB and the Commission. Commission and the EFC cover macroeconomic and financial issues. And the Economic Policy Committee is concerned with structural policies.

[*] Lisbon Treaty

Chapter 4: Analysis of the Greek debt crisis

Economic crisis arrived in Europe in August 2008. It changed the economic and fiscal situation. The sector of public finance was undermined by the very sharp decline in economic activity. **Table 4** shows the change of the government balance in the Eurozone countries. In 2009 the Greek government balance was -13.6% of its GDP, comparing to -3.3% of German's. For that year it was the second worst result among other 16 EMU states.

Table 4: General Government Balance in the Eurozone Countries, in % of GDP

Country	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Eurozone	-1,4	0,0	-1,9	-2,6	-3,1	-2,9	-2,5	-1,3	-0,6	-2,0	-6,3	-6,6
Austria	-2,3	-1,7	0,0	-0,7	-1,4	-4,4	-1,6	-1,6	-0,6	-0,4	-3,4	-5,6
Belgium	-0,6	0,0	0,4	-0,1	-0,1	-0,3	-2,7	0,3	-0,2	-1,2	-6,0	-6,3
Cyprus	-4,3	-2,3	-2,2	-4,4	-6,5	-4,1	-2,4	-1,2	3,4	0,9	-6,1	-6,3
Finland	1,6	6,9	5,0	4,1	2,6	2,4	2,8	4,0	5,2	4,5	-2,2	-4,2
France	-1,8	-1,5	-1,5	-3,1	-4,1	-3,6	-2,9	-2,3	-2,7	-3,4	-7,5	-7,1
Germany	-1,5	1,3	-2,8	-3,7	-4,0	-3,8	-3,3	-1,6	0,2	0,0	-3,3	-4,6
Greece	-	-3,7	-4,5	-4,8	-5,6	-7,5	-5,2	-2,9	-3,7	-7,7	-13,6	-7,1
Ireland	2,7	4,8	0,9	-0,4	0,4	1,4	1,7	3,0	0,3	-7,2	-14,3	-13,3
Italy	-1,7	-0,8	-3,1	-2,9	-3,5	-3,5	-4,3	-3,3	-1,5	-2,7	-5,3	-5,6
Luxembourg	3,4	6,0	6,1	2,1	0,5	-1,1	0,0	1,3	3,7	2,5	-0,7	-4,4
Malta	-7,7	-6,2	-6,4	-5,5	-9,9	-4,7	-2,9	-2,6	-2,2	-4,7	-3,8	-4,4
Holland	0,4	2,0	-0,2	-2,1	-3,1	-1,7	-0,3	0,5	0,2	0,7	-5,3	-5,7
Portugal	-2,8	-2,9	-4,3	-2,8	-2,9	-3,4	-6,1	-3,9	-2,6	-2,7	-9,4	-7,3
Slovakia	-7,4	-12,3	-6,5	-8,2	-2,8	-2,4	-2,8	-3,5	-1,9	-2,3	-6,8	-4,4
Slovenia	-3,0	-3,7	-4,0	-2,5	-2,7	-2,2	-1,4	-1,3	0,0	-1,8	-5,5	-5,6
Spain	-1,4	-1,0	-0,6	-0,5	-0,2	-0,3	1,0	2,0	1,9	-4,1	-11,2	-12,5

Source: Prokopijević,Miroslav. "Euro Crisis." PANOECONOMICUS 3 (2010) p.373

4.1 Buildup and outbreak of the crisis

A fall of GDP for more than -2% justifies a deficit surpassing -3% (Prokopijević 374). There are several reasons for that deficit. First, countries were not ready to reduce the gap between high expenditures and low revenues. **Table 5** contains data of Greek government deficit and surplus for 2009. At this year the deficit of Greece was three times bigger comparing to that of 2006. Second, due to a rise in layoffs, more people get unemployment compensation and this expenditure is higher. Third, the fiscal stimulus in the euro area in 2009 and 2010 is estimated to be at least 2% of GDP per year (Prokopijević 374). Fourth, rising risks in debt service enlarged

risk spreads, making debt service and borrowing more costly for a majority of euro area countries.

Table 5: GDP, government deficit/surplus and debt in Greece for 2009

		2006	2007	2008	2009
Greece					
GDP mp	(million euro)	211 314	227 134	236 936	235 035
Government deficit (-) / surplus (+)	(million euro)	-12 109	-14 465	-22 363	-36 150
	(% of GDP)	-5.7	-6.4	-9.4	-15.4
Government expenditure	(% of GDP)	45.2	46.5	49.2	53.2
Government revenue	(% of GDP)	39.1	39.8	39.7	37.8
Government debt	(million euro)	224 204	238 581	261 396	298 032
	(% of GDP)	106.1	105.0	110.3	126.8

Source: Eurostat. November 2010

During the decade preceding the global financial crisis that started in fall 2008, Greece's government borrowed heavily from abroad to fund substantial government budget and current account deficits (Nelson, Belkin, and Mix 2).

> Between 2001, when Greece adopted the euro as its currency, and 2008, Greece's reported budget deficits averaged 5% per year, compared to a Eurozone average of 2%, and current account deficits averaged 9% per year, compared to a Eurozone average of 1%. In 2009, Greece's budget deficit is estimated to have been more than 13% of GDP (World Economic Outlook 2009).

Many attribute the budget and current account deficits to the high spending of successive Greek governments.

Greece funded these deficits by borrowing in international capital markets, leaving it with a chronically high external debt (Country Report 2010). Both Greece's budget deficit and external debt level are well above those permitted by the rules governing the EU's Economic and Monetary Union. Specifically, the TEU calls for budget deficit ceilings of 3% of GDP and external debt ceilings of 60% of GDP. Greece is not alone, however, in exceeding these limits. Of the 27 EU member states, 25 exceed these limits.

Greece's reliance on external financing for funding budget and current account deficits left its economy highly vulnerable to shifts in investor confidence. The outbreak of the global financial crisis in fall 2008 led to a liquidity crisis for many countries, including several Central

and Eastern European countries. In contrast, the Greek government initially weathered the crisis relatively well and had been able to continue accessing new funds from international markets. However, the global recession resulting from the financial crisis put strain on many governments' budgets, including Greece's, as spending increased and tax revenues weakened.

The fears of investors have centered on Greece's fiscal position and outlook, which have deteriorated significantly over the past year. The spread between Greek and German 10-year yields has increased at the beginning of 2008 (Nelson, Belkin, and Mix 4). This spread widening reflects a process of credit differentiation which has gone on across the euro area during the recession and financial crisis. The situation in Greece has been far more dramatic than in other weaker Eurozone countries.

The key factor underlying the abrupt sell-off in Greek bonds has been a disturbing depreciation in the country's fiscal position. In October 2009 the new socialist government revised up the estimate for the 2009 budget deficit from 6.7% of GDP to 12.7% of GDP (Is Greece heading for default 4). This move shocked investors not only because of the scale of the upgrade, but also because of the admission by the Greek authorities that past deficit figures had been misleading. Figures prove an underestimate. Cash measures of the deficit for 2009 look significantly larger and there have been significant recent downward revisions to GDP.

Before the crisis, Greek 10-year bond yields were 10 to 40 basis points above German 10-year bonds. With the crisis, this spread increased to 400 basis points in January 2010, which was at the time a record high (qtd. in Nelson, Belkin, and Mix 3). High bond spreads indicate declining investor confidence in the Greek economy. **Table 6** contains the data on foreign direct investments in Greece. Despite increasing nervousness surrounding Greece's economy, "the Greek government was able to successfully sell €8 billion in bonds at the end of January 2010" (Nelson, Belkin, and Mix 3). However, Greece must borrow an additional €54 bilion to cover maturing debt and interest payments in 2010.

At the end of March 2010, Eurozone member states pledged to provide financial assistance to Greece in concert with the International Monetary Fund, if necessary, and if requested by Greece's government. Negotiations and discussions about the package continued in April 2010, when Eurostat released its estimate of Greece's budget deficit. This led to renewed questions about Greece's ability to repay its debts. On April 23, 2010, the Greek government formally requested financial assistance from the IMF and other Eurozone countries. In late April 2010, the spread between Greek and German 10-year bonds reached a record high of 650 basis points, and one of the major credit rating agencies, Moody's, downgraded Greece's bond rating by one notch (Is Greece heading for default 6). On April 2010 the status of Greek bonds was rated to "junk" status.

In meetings with members of the German Parliament, IMF Managing Director Dominique Strauss-Kahn reportedly raised the prospect of a three-year assistance package to Greece totaling €110 billion. As negotiations among the IMF, Eurozone member states, and Greece continued. Greece agreed to additional austerity measures. The Greek government has promised to slash its public deficit from nearly 13% of gross domestic product to nearly nine percent of Gross Domestic Product by the year's end. Greece's debt is currently estimated at more than $404 billion - or about 113 percent of its GDP (VOANews.Com).

Despite the substantial size of the financial assistance package, the threat of Greece's crisis spreading to other Eurozone countries remained. Bond spreads for several other European countries spiked and the euro started to depreciate rapidly. In a bid to "save the euro," on May 9, 2010, European Union governments announced that they would make an additional €500 billion available to vulnerable European countries (Nelson, Belkin, and Mix 4). Following the announcement, the market reacted positively, as bond spreads for several vulnerable European countries dropped and the euro began to strengthen.

4.2 Possible causes – domestic and international

Greece's current economic problems have been caused by a mix of domestic and international factors. Domestically, high government spending, structural rigidities, tax evasion, and corruption have all contributed to accumulation of debt. Internationally, the adoption of the euro and lax enforcement of EU rules that are aimed at limiting the accumulation of debt are also have contributed to Greece's current crisis.

Between 2001 and 2007, Greece's GDP grew at an average annual rate of 4.3%, compared to a Eurozone average of 3.1% (IMF 2009). High economic growth rates were driven primarily by increases in private consumption and public investment financed by the EU and the central government. Over the past six years, however, central government expenditures increased by 87%, revenues grew by only 31%, leading to budget deficits well above the EU's agreed-upon threshold of 3% (Greek Ministry of Finance 2010). Observers also identify a large and inefficient public administration, costly pension and healthcare systems, tax evasion, and the absence of the will to maintain fiscal discipline as major factors behind Greece's deficit. According to the OECD, as of 2004, spending on public administration as a percentage of total public expenditure in Greece was higher than in any other OECD member, with no evidence that the quantity or quality of the services are superior (Economic Survey 2007). This trend has continued. Greek government expenditures in 2009 accounted for 50% of GDP, with 75% of public spending going to wages and social benefits (IMF Survey online 2010). Greek governments have taken steps to modernize and consolidate the public administration. However, observers continue to cite poor productivity in the public sector as an obstacle to improved economic performance. An aging Greek population is expected to rise could place additional burdens on public spending. According to the OECD, Greece's replacement rate of 70%-80% of wages is high, and entitlement to a full pension requires only 35 years of contributions, compared to 40 in many other countries (Economic Survey 2009).

Weak revenue collection has also contributed to Greece's budget deficits. Many economists identify tax evasion and Greece's unrecorded economy as key factors behind the deficits. They argue that Greece must address these problems if it is to raise the revenues necessary to improve its fiscal position. Observers offer a variety of explanations for the prevalence of tax evasion in Greece, including high levels of taxation and a complex tax code, excessive regulation, and inefficiency in the public sector. Prime Minister Papandreou has committed to cracking down on tax and social security contribution evasion. Observers note, however, that past Greek governments have had, at best, mixed success seeing through similar initiatives (Nelson, Belkin, and Mix 6).

Greek industry is suffering from declining international competitiveness. Economists cite high relative wages and low productivity as a primary factor. Wages in Greece have increased at a 5% annual rate since the country adopted the euro, about double the average rate in the Eurozone as a whole. Over the same period, Greek exports to its major trading partners grew at 3.8% per year, only half the rate of those countries' imports from other trading partners (Is Greece heading for default 7). Some observers argue that for Greece to boost the competitiveness of its industries and reduce its current account deficit, it needs to increase its productivity, significantly cut wages, and increase savings. As it was discussed by many scholars and officials Papandreou government has begun to restrain public sector wages and hopes to increase Greek exports through investment in areas where the country has a comparative advantage. In the past, tourism and the shipping industry have been the Greek economy's strongest sectors.

Greece's adoption of the euro as its national currency in 2001 is seen by some as a contributing factor in Greece's buildup of debt. With the currency bloc anchored by economic heavyweights Germany and France, and a common monetary policy conservatively managed by the ECB (Nelson, Belkin, and Mix 6), investors have tended to view the reliability of euro member countries with a heightened degree of confidence. The perceptions of stability conferred by euro membership allowed Greece to borrow at a more favorable interest rate making it easier

to finance the state budget and service existing debt. However, this benefit may also have contributed to Greece's current debt problems. Observers argue that access to artificially cheap credit allowed Greece to accumulate high levels of debt. Critics assert that if the market had discouraged excess borrowing by making debt financing more expensive, Greece would have been forced to come to terms earlier with the need for austerity and reform (Nelson, Belkin, and Mix 6).

The lack of enforcement of the Stability and Growth Pact is also seen as a contributing factor to Greece's high level of debt. In 1997, EU members adopted the Stability and Growth Pact. They agreed to enhance the surveillance and enforcement of the public finance rules set out in the Maastricht Treaty's convergence criteria for EMU. The 1997 Stability and Growth Pact clarified and sped up the excessive deficit procedure to be applied to member states that surpassed the deficit limit. If the member state is deemed to have insufficiently complied with the corrective measures recommended by the European Commission and the Council of the European Union during the excessive deficit procedure, the process may ultimately result in a fine of as much as 0.5% of GDP (Resolution of the European Council 1997).

Following the launch of the euro in 1999, an increasing number of member states found it hard to comply with the limits set by the Pact. Since 2003, more than 30 excessive deficit procedures have been undertaken. The EU, however, has never imposed a financial sanction against any member state for violating the deficit limit. The lack of enforcement of the Stability and Growth Pact is thought to have limited the role the EU can play in discouraging countries to reduce debt level.

The European Commission initiated an excessive deficit procedure against Greece in 2004 when Greece reported an upward revision of its 2003 budget deficit figure to 3.2% of GDP. In its report, the Commission indicated that the quality of public data is not satisfactory, noting that the Eurostat had not certified or had unilaterally amended data provided by the National Statistical Service of Greece since 2000 (European Commission 2004). Subsequent statistical

revisions between 2004 and 2007 revealed that Greece had violated the 3% limit in every year since 2000, with its deficit topping out at 7.9% of GDP in 2004 (Nelson, Belkin, and Mix 7). The Commission also noted that Greece's debt had been "above 100% of GDP since before Greece joined the euro" (IMF 2009), and that the statistical revisions had pushed the debt number up as well. The EU closed the excessive deficit procedure in 2007, with the Commission pronouncing itself satisfied that Greece had taken sufficient measures, "mainly of a permanent nature," and that the country's deficit would be 2.6% of GDP in 2006 and 2.4% in 2007 (Nelson, Belkin, and Mix 7). The Commission also concluded that "the Greek statistical authorities improved their procedures," leading to "an overall higher quality of data" (European Commission 2007). The Commission opened a new excessive deficit procedure in 2009 when Greece's 2007 deficit was reported at 3.5% of GDP (European Commission Country-specific procedure), and that procedure is ongoing in the context of the current situation.

4.3 Shipping and tourism industries after the crisis

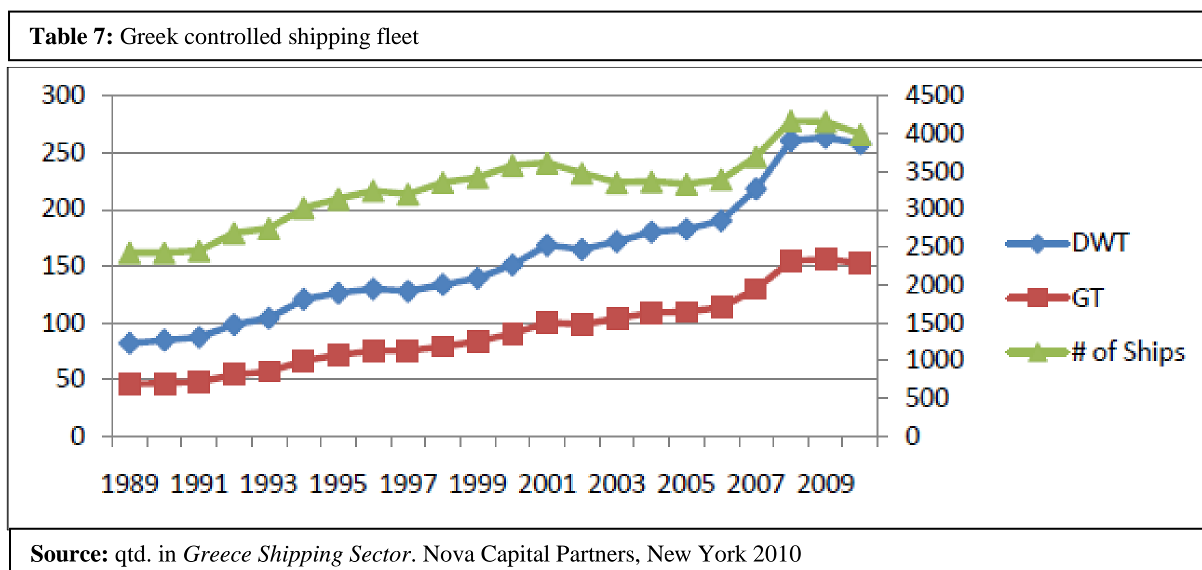
Hence the crisis is a significant event for a country, this chapter narrates about its influence on main economic sectors of Greek economy. Thus the full image will be drawn. Food, tobacco processing, chemicals, textile, metal products, petroleum and industrial products are among the main industries of the Greek economy. And this chapter reviews situation with two biggest and most important sectors that are tourism and shipping.

Historically and traditionally Greece is the marine nation. This sector of economy represents 8% of the countries GDP and controls 40% of the European vessels (Greece Shipping Sector 1). Most Greek-owned shipping firms are now located in Greece, and in 2008 shipping accounted for a net income of 11 billion euro in the Greek economy, covering around a quarter of the country's trade deficit (Icaza, Marzo, Popa, Sahbaz and Saravelos 14-15). Thus, Greece is one of the main contributors of the EU marine trade. Illustrating the importance of the sector to Greece's economy, total commitments from the domestic and international banking community

amounted to $67 billion at year-end 2009, and these commitments have been growing during 2010, with a positive outlook for 2011 and beyond based on a gradually improving domestic and global economy (Greece Shipping Sector 1). During several years there was a steady increase in terms of different kinds of shipping transportation; however the last two years show the decrease though not a big as it was supposed. **Table 7** graphically represents the change in volume of vessels, dead weight tonnage and gross tonnage for the period of twenty years. It also shows that their volume didn't changed significantly after the outburst of 2008 global crisis.

Crisis caused global banking problems, loss of consumer confidence, the significant downturn of international trade and the decreasing value of vessels. However, the effect on with both treading carefully as to find a way to ride out the storm and deal with lower cash flows and vessel value problems (Greece Shipping Sector 6).

Table 7: Greek controlled shipping fleet



Source: qtd. in *Greece Shipping Sector*. Nova Capital Partners, New York 2010

Greek ship finance has been of little size without any mergers, acquisitions, bankruptcy, or substantial lay-offs. It is said that this year 2010 was a year of adaptation by both owners and banks.

Despite challenges mentioned above 2010 has shown some signs of recovery as the rate of decline of Greek ship finance has slowed down in terms of the presence of different banks of the

world who seek to take advantage of the nowadays situation in Greek shipping sector, “to capitalize on market opportunities arising from the weak economy, the Greek government’s foreign direct investment incentives, and general government reform providing grounds for increased competition (Greece Shipping Sector 6, Icaza, et al. 28).

Tourism is another main economic sector, which represents 15% of country’s GDP and almost 17% of the employment. Thus, a change in economic situation can significantly influence on the economy of Greece. The economic downturn can cost five billion euro for Greek tourism industry (The Herald Sun 2011). The association of Greek tourism enterprises estimates 20% decrease of booking in nationwide arrivals and in cruise shipping, 50% fall in luxury boat booking. These numbers predict that this year there will approximately three million tourists less than last year. Comparing to the British pound and East European currencies the euro raised significantly, therefore Egypt and Turkey became cheaper and more attractive to spend summer vacancies. People in Greece are unsatisfied, they protest on the streets and this makes travelers from around the world to postpone or even cancel their trips. And as a result all those who involved in the tourism sector lose expected revenues. The Greek government reduced the airport fees and the docking fees for cruises as a result airline and cruise companies benefit (TravelObserver.Com).

Crisis-stricken Greece plans to spend more than 20 million of euro over the next three years on improving visitors’ service at historic sites and museums to boost tourism (FoxNews.Com). The reason is that most of Greek museums and monuments lack basic services e.g. restrooms, parking lots etc; and none of the most popular places meet requirements such as translated signs or facilities for blind people.

Thus in contrast with the shipping, Greek tourism suffers significantly and needs for substantial funding to be improved.

4.4 Consequences of the crisis for Greece and the EMU

Previous chapters analyzed the causes that caused the crisis and showed its influence on the main sectors of Greek economy. Now the outcomes must be investigated. It suggests the consequences of the crisis both for Greece – with positive and negative possibilities – and for the European Union.

In order to return to a situation of credible EMU commitment Greece must have the willingness and the ability to implement those reforms that are strongly necessary to improve it's the fundamentals of its economy. As well it must now convince markets not only that she wants but also can implement the required reforms (Arghyrou and Tsoukalas 16). Thus, Greece can meet positive or negative outcomes.

"In positive case Greek government will show determination in implementing reforms" (Arghyrou and Tsoukalas 16) and with a condition that public opinion will support them without strong opposition. One more condition of this case is that recession won't be delayed and no any further shocks will appear. In addition it supposes tradeoffs between short-term looses and long-term benefits. It will show the progress in implementation of the reforms and will give a strong degree of confidence that Greece will gradually be able to build them. In time, reforms will be seen to have progressed enough to establish full confidence in Greece's ability to maintain EMU participation, allowing withdrawal of the emergency EU/IMF fiscal guarantee and a gradual return to a regime of credible commitment and fiscal sustainability (Arghyrou and Tsoukalas 16). Finally, Greece will achieve the sustainable growth of the economy that will be strong and restructured.

The negative case supposes that the government while implementing reforms will meet strong public resistance against them. In that case, markets will refuse to lend Greece funds and the EU/IMF rescue mechanism, which will certainly involve conditionality clauses, will be discontinued (Arghyrou and Tsoukalas 17). In this way Greece will have no other option rather than to abandon the euro and to leave the EMU. Thus, Greece will re-establish drachma which

will be highly devaluated against euro. In this case Greece looses the financial support of the EMU.

Thus the success of the government reforms is fully dependable on the public opinion.

Euro is a single currency for 17 countries, whose economies are, thus, interconnected, different and dependent on each other. Therefore, the economic instability shift the balance and others have to be alerted. Although none of the other periphery EMU countries tick, as Greece does, all boxes in the explosive triplet of budget deficit, current account deficit and debt to GDP ratio, they are either close of doing so or they converge fast towards that point (Arghyrou and Tsoukalas 19). Any further increase in the budget deficit of these countries can lead to the default of the bonds and the emergence the Greece-like situation. In order to avoid the same situation as Greece has these countries have to introduce economic reforms that will show their capacity for further participation in the EMU. Spillover from Greece into Balkans might be possible too via trade and, more importantly, via financial links (Georgios P. Kouretas, Prodromos Vlamis 398). The financial links of the Greek banks are widespread and they are “aggressive lenders” in Balkans countries.

Chapter 5: Analysis of the solutions to meet the crisis

Today Greece government implements an austerity plan to reduce budget deficit. IMF and the EU designed a rescue package to bail Greece out. This chapter investigates both of these plans and as well discuses what Greece can continue to do or what new can be done.

5.1 Greek austerity plan

Any austerity plan supposes the sharp and harsh decrease of budget spending. And the Greek government of Papandreou applied a series of austerity fiscal measures. The main principles of its plan are to cut spending and to increase taxes. However, they did not appear to enable Greece to raise money to pay for its debts. Investors don't express a lot of confidence about Greek survival and further stable functioning.

In autumn 2009 Greek government announced about the creation of the three different packages of fiscal measures. Their main aim is to decrease the deficit from 13.6% in 2009 below 3% (Maastricht criteria!) in 2012. The austerity plan was detailed in the Stability and Growth Programme for Greece. It was submitted to the European Commission on January 2010 and approved on February.

The specific longer-term budget deficit targets established by the government are 8.7% of GDP in 2010; 5.6% of GDP in 2011; 2.8% of GDP in 2012; and 2% of GDP in 2013 (Greek Ministry of Finance 2010). The main features of the tax revenues are about the increase of the VAT. The main VAT is to be raised from 21% to 23%. The government expects the new VAT increases to generate additional revenues of €0.80bn (or 0.3% of GDP) in 2010 and €1.00 bn (or 0.4% of GDP) in 2011 (Georgios P. Kouretas, Prodromos Vlamis 398). Another measure is the increase of the tax on fuels, tobacco products and bevarages, which is supposed to bring an increase of the revenues from 0.2% of GDP in 2010 to 0.3% in 2011. As well taxes on luxury goods, introduction of the 'green tax' and on firms' profits are the measures to increase the revenues in budget. The measures to cut spending are sharp as well and focus on the cuts in civil services. Thus the 13th and 14th annual salary installments will be abolished for civil servants

earning a gross salary in excess of €3,000/month; the Public Investment Budget for 2010 will be reduced by €0.5bn (or 0.2% of GDP); a 3-year freeze in wages and pensions and further cut backs in central government operational costs (Georgios P. Kouretas, Prodromos Vlamis 398).

There is a hope that this program will stabilize the economy and will make it to go up. However, the mix of taxes that are to be increased and sharp cuts in spending could lead to a worse situation. It can result in even higher unemployment, decrease in demand for goods and services and can cause deepen of the recession. Therefore, the monetary and fiscal authorities of Greece have to plan and implement such measures that will push the economic growth and the reduction of unemployment simultaneously.

At the same time government announced that the structure of Greek economy requires the changes to be brought in public administration, health care and pension systems; and measures to improve situation with employment, the development of the private sector, more support for innovations and researches etc.

Comparing to the other European pension systems the Greek one is seen as far from the strictest one. Therefore, the government decided to raise the retirement age and to change the calculation principle based on the lifetime contribution. Papandreou has announced a similar effort to tighten public regulation and strengthen accountability in what is widely considered an inefficient Greek health care system (Nelson, Belkin, and Mix 9). The restructure of the public administration will concern about the reducing of the local government authorities and legal public entities. For now the unemployment is accelerating quite quickly. And the Greek government hopes to counter these trends by attracting new foreign investment in Greece and by boosting exports of goods and services (Nelson, Belkin, and Mix 9). As well authorities plan to strengthen sectors with strong comparative advantages for trade and investments. However, public opinion has been divided almost equally in terms of the question whether all these measures are good or they aren’t.

5.2 IMF/EU rescue package

The EU currency was not introduced because of economic considerations, but because the European Union is pretending to be a genuine state and states are expected to have single national currencies

On April 23, 2010 Greece formally asked for financial help other Eurozone countries. After the mechanism of financial assistance was designed composing of bilateral loans. One part is an assistance of the EMU members which is borrowed with a 5% of interest rate; the second part is loaned by the IMF. The three years rescue package is worth about 110 billion of euros. The largest bilateral loans from EMU are provided by Germany and France. And these countries demanded for a detailed plan of measures, thus Greece must show an ability to serve its austerity plan.

At the beginning the EU insisted that the Greek crisis is of its own concern. It was an attempt to demonstrate its strength and ability to take care of the problems. ECB and other officials were strongly opposed to the intervention of someone from outside. However, IMF involvement was reportedly a key condition of Chancellor Merkel's willingness to compromise and agree to the "safety net" mechanism (Nelson, Belkin, and Mix 11). Previously Greek authorities told that they would ask for the IMF assistance if the EU failed to provide help.

Of course, a lot of disputes arose after the EMU decision to help Greece. The concern is about whether other members should pay for the Greek mistakes and thus bail it out. According to the definition of the bailout, it involves an injection of liquidity into a failing company, or in this case a country, to keep it from going under; the sources of this liquidity can vary (WiseGeek.Com). Authorities undertake the bailout in case when the consequences of the collapse of the company/country will be terrible. In the legislation of the EU there is no a legal basis that prescribes clearly on bailout and what kind of procedure it must have. Neither TEU not the Lisbon treaty contains any mechanism for such case. Some countries e.g Slovenia, Slovakia etc. are strongly against to bailout with or without any legal bases. Moreover, the German

economy has also been badly affected by the crisis. Last year, Germany's GDP fell by 5%, the biggest drop since the war, with a drop of 15% in exports and 20% in sales of German manufacturers (Belien 2010). The German people are not prepared to lift countries such as Greece, Romania, Spain, Portugal and Ireland out of the recession at its own expense.

However, in spite this opposition, not only 17 members of the EMU today are obliged to bailout, but all other 26 members of the EU can be make to do so. In December 2010 the Article 122 of the TEU went into force. Now this article may be seen as a legal base to bailout. It sais "where a member state is in difficulties or is seriously threatened with severe difficulties caused by natural disasters or exceptional occurrences beyond its control, the council of ministers, on a proposal from the European Commission, may grant, under certain conditions, Union financial assistance" (Belien 2010). The decision must be taken by majority voting. And even countries which opted out e.g. Britain might be forced to provide an assistance if the Council requires under this article. The biggest fear is that if they provide assistance for Greece other countries like Spain, Portugal, Ireland, Italy may ask for help. And this consequently means that France, Germany, the UK etc. may be required to contribute even more money.

Conclusion

The global crisis that hurt economies a lot is presented since 2008 and makes be nervous about the future consequences. As one of the world's biggest markets the EU met challenges. The EU is a unification of different sovereign countries. The monetary policy that fits everybody is hardly to achieve and it may be not appropriate to all EMU members. Therefore, some countries express less willingness to help others to meet the crisis. The shift of the balance in stability and opinions appears.

Current situation with Greek economy is a huge challenge for the EU and the EMU to show their ability for well functioning. As the 17 economies are interconnected by the euro, an event such as debt crisis in one country causes the reaction of other economies. However, it is quite disputable that only the Greek debt crisis will provoke the collapse of the euro system and the EMU. Thus, today the Papandreou government has to implement the measures of the austerity plan and ask for financial assistance from EU and IMF designed in the rescue package. Nevertheless, it is quite disputable if these plans can strengthen the Greek economy. In short-term until 2012 they supposed to cover the budget deficit, but there is a doubt that they are able to raise the Greek economy at the same level as the best EU countries have. It may remain in the group of poor Europe. Thus the crisis will have a positive effect only in terms of the deficit recovery, but not the economy strengthening. Moreover the Greek government has to take into account the public opinion on the policies and plans they implement.

In addition, many people think of a possibility for Greece to return to drachma. In this case Greece will take back the right to establish its own monetary policy and it will be independent from the EU decisions. But this case seems very unreal to be happen. Greece would have to abandon the euro and simultaneously leave the EU. It would negatively influence the whole euro system and the EMU member states. The devaluation of the re-established drachma might be very big and cause the worse situation than it is now both in Greece and the EMU.

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Appendix

Table 6: Net Foreign Direct Investment in Greece by country of origin (in mln. euros)

Source: Bank of Greece, Statistics Department 201

	2010	2009	2008	2007	2006	2005	2004	2003
COUNTRY OF ORIGIN								
TOTAL	**1651,9**	**1 753,8**	**3 071,1**	**1 542,7**	**4 268,8**	**501,3**	**1 692,4**	**1 129,9**
EUROPE	**1686,4**	**1 624,3**	**2 982,0**	**1 498,0**	**4 223,8**	**298,2**	**1 444,8**	**1 386,4**
EUROPEAN UNION	**1569,7**	**1 561,1**	**2 907,9**	**1 440,8**	**4 058,7**	**231,9**	**1 355,1**	**1 660,3**
EURO AREA	**1766,6**	**1 601,4**	**3 043,3**	**1 679,2**	**3 310,0**	**-21,9**	**697,4**	**953,2**
AUSTRIA	**-51,3**	**182,8**	**-37,2**	**-10,2**	**48,3**	**65,6**	**19,9**	**6,7**
BELGIUM	**-74,3**	**-84,1**	**-194,6**	**-34,1**	**65,6**	**-46,0**	**1,5**	**-6,6**
GERMANY	**210,2**	**670,5**	**2 941,4**	**267,5**	**-72,9**	**-225,3**	**-220,2**	**-56,9**
SPAIN	**-45,5**	**67,5**	**59,9**	**255,9**	**24,5**	**45,9**	**3,3**	**14,8**
FINLAND	**6,5**	**4,4**	**3,2**	**1,0**	**1,1**	**0,3**	**-1,1**	**0,0**
FRANCE	**1005,8**	**426,8**	**-211,2**	**307,1**	**2 340,3**	**235,5**	**309,1**	**212,3**
IRELAND	**14,5**	**43,5**	**41,9**	**14,7**	**13,2**	**19,4**	**3,2**	**-10,4**
ITALY	**-158,7**	**-88,2**	**-16,9**	**17,8**	**92,8**	**96,1**	**72,5**	**92,0**
LUXEMBOURG	**269,8**	**245,3**	**270,0**	**390,3**	**147,1**	**256,8**	**406,0**	**506,8**
NETHERLANDS	**221,1**	**138,6**	**-79,1**	**215,1**	**414,9**	**-565,0**	**83,9**	**158,6**
PORTUGAL	**0,5**	**0,0**	**-0,1**	**0,5**	**28,7**	**38,1**	**0,3**	**29,2**
SLOVENIA	**-0,3**	**-0,3**	**0,0**	**0,4**	**0,0**	**0,0**	**0,0**	**0,0**
CYPRUS	**366,8**	**-5,5**	**254,2**	**253,2**	**206,2**	**56,6**	**19,0**	**6,7**
MALTA	**1,5**	**0,0**	**11,5**	**0,0**	**0,2**	**0,0**	**0,0**	**0,0**
SLOVAKIA	**0**	**0,1**	**0,3**	**0,1**	**0,0**	**0,0**	**0,0**	**0,0**

EU MEMBERS NOT BELONGING TO EURO AREA	-196,9	-40,3	-135,4	-238,4	748,6	253,9	657,7	707,1
DENMARK	4,5	-2,5	-31,3	3,7	-45,8	-5,5	-3,3	0,9
UNITED KINGDOM	-216,1	-49,8	-115,9	-268,4	783,2	259,0	648,9	701,8
SWEDEN	6,9	8,7	5,0	8,0	5,3	13,7	10,7	4,6
CZECH REPUBLIC	4,5	0,7	0,5	0,1	0,0	0,0	0,1	0,0
ESTONIA	0,3	0,4	1,5	0,2	0,1	0,0	0,0	0,0
HUNGARY	0,2	0,0	-0,1	7,8	1,3	-0,1	3,1	0,0
LITHUANIA	0,6	0,1	0,0	1,3	0,3	-12,3	0,6	0,0
LATVIA	3,6	1,1	0,8	1,9	0,1	0,1	0,1	-0,4
POLAND	-1,2	-0,3	0,8	-4,3	2,3	-0,7	-0,6	0,0
BULGARIA	-1,6	0,8	5,2	6,0	0,6	-0,1	-0,8	0,1
ROMANIA	1,4	0,5	-1,9	5,3	1,3	-0,4	-0,9	0,1
OTHER EUROPEAN COUNTRIES	116,7	63,2	74,1	57,2	165,1	66,3	89,7	-273,9
of which: ALBANIA	1	0,2	0,2	0,2	0,2	0,2	0,2	1,2
SERBIA & MONTENEGRO	1,7	0,0	0,2	0,3	-0,4	0,4	0,1	0,1
CROATIA	-0,1	0,0	0,3	0,1	0,0	0,0	0,2	0,0
FYROM	0	0,0	0,2	-0,3	0,1	0,0	0,0	-0,1
SWITZERLAND	48,8	56,1	63,0	37,3	72,3	41,4	69,9	-11,5
TURKEY	0,5	-0,2	1,2	-0,9	0,0	-0,3	-0,5	-0,1
RUSSIAN FEDERATION	4	4,8	5,6	9,3	0,7	6,4	6,4	-4,3
AMERICA	-21,4	30,0	79,2	54,1	-373,5	190,6	267,7	-11,9
of which: USA	-20,7	32,8	64,2	41,6	94,9	97,1	215,9	4,6
CANADA	-0,7	-3,5	-1,3	0,2	3,4	1,9	1,9	-1,0

OCEANIA	**-0,3**	**-1,9**	**-3,4**	**0,3**	**5,0**	**-1,3**	**0,7**	**-0,9**
of which: AUSTRALIA	**0**	**-2,1**	**-2,9**	**-2,1**	**4,9**	**-1,4**	**-1,3**	**-0,9**
ASIA	**21,2**	**124,5**	**29,4**	**-4,9**	**400,9**	**1,4**	**6,8**	**2,5**
of which: CHINA	**1,2**	**0,1**	**0,0**	**-0,7**	**0,0**	**0,0**	**0,0**	**0,0**
JAPAN	**2,7**	**6,7**	**1,0**	**-4,5**	**0,3**	**1,2**	**2,4**	**-4,0**
AFRICA	**-33,5**	**-33,0**	**-19,0**	**-3,0**	**8,0**	**6,4**	**2,3**	**5,7**
of which: EGYPT	**0**	**0,3**	**-3,6**	**0,1**	**0,1**	**0,0**	**0,0**	**0,0**
NON ALLOCATED COUNTRY	**-0,5**	**9,9**	**2,9**	**-1,8**	**4,6**	**5,9**	**-29,9**	**-251,8**