University of Essex

THE ROLE OF INTERNATIONAL FINANCIAL INSTITUTIONS IN THE GREEK DEBT CRISIS

Term paper

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Table of Contents

OPENING SECTION : Message on authenticity 2
ABSTRACT 3
SECTION 1 : Background 4
1.1 Maastricht Treaty and its requirements 4
1.2 Early signs 4
1.3 “A very sexy story between two sinners” 4
1.4 Shadowed truth 5
1.5 “Dream games” and Financial Crisis of 2008 5
SECTION 2 : Official Support for Greece 7
2.1 Introduction to IMF and the ‘Troika’ 7
2.2 Three bailout packages 7
2.3 Public concerns 8
SECTION 3 : European Stability Mechanism 10
3.1 In the need 10
3.2 EFSF, ESM, and their functions 10
SECTION 4 : IMF in the Crisis: A Critical Assessment 11
4.1 Role of the IMF: Overview 11
4.2 Possible solutions and tactics 11

OPENING SECTION : Message on authenticity

I, Anna Kurhanovych, confirm that this assignment is my own work, where I have referred to academic sources, provided appropriate in-text citations and included the sources in the final reference list.

ABSTRACT

The Greek debt crisis, which slowly unfolded after the establishment of European Monetary Union, stands as one of the most influential episodes of the history of European Union and international finance. Direct influence on the state of this crisis was caused by key European and international organisations, some of them being created as a counter-measure to the financial situation in the EU.

Being a comprehensive assessment of many governmental reports and articles, this term paper explores the very theme of Greek debt crisis, its true pretexts, and response of the global organisations with a close assessment of their tactics and motives.

With a proper amount of criticism, this paper evaluates rights and wrongs in strategies of various international instituions, like European Union, International Monetary Fund, European Finacial Stability Facility and so on; considering flaws and alternative methods that could have been implemented. It examines lessons learned from this and other crises and knowledge obsained from history. Ultimately, this paper contributes to a deeper understanding of an intertwined nature of financial institutions in the world, sovereign states, and political and economic mechanisms of a country.

SECTION 1 : Background

1.1 Maastricht Treaty and its requirements

In 1992, the twelve european countries signed the Maastricht Treaty, which soon came into force to establish the European Union on the 1st November 1993, already setting a goal to bring the single currency into its borders. After six years, this goal was achieved, bringing euro into 11 countries. Unfortunately, Greece was not among them, as it failed to keep up with three fiscal rules, established by the Maastricht Treaty - inflation below 1.5 percent, a budget deficit below 3 percent, and a debt-to-GDP ratio below 60 percent. (Council on Foreign Relations, 2024)

1.2 Early signs

The history of this deplorable situation dates back to the start of 1980s, when socialistic party came in power and started throwing generous social benefits at the people of Greece, spending money got by abusive external borrowing and evading taxes – as the result, Greece drowns in debts and its debt-to-GDP ratio jumps by 55% in just ten years, reaching whooping 110% at the end of 1990s. (Kouretas and Vlamis, 2010) This is the starting cause of Greece's financial struggle.

1.3 "A very sexy story between two sinners"

In 2001, in only two years after being assessed as unable to meet the Maastricht criteria, Greece suddenly seems to resolve its economic problems, thus being allowed to swap its national currency for euro. The truth behind this improvement was a series of government statistical manipulations in order to

conceal Greece’s true economic status, including engaging in a deal with Goldman Sachs investment bank – a loan of 2.8 billion euros, executed at a fictional exchange rate, so that it sounded really attractive to Greek government in its time of need. By doing this, Greece “covered” a bit of its government debt and made it closer to meeting the EU standards. Christoforos Sardelis comments: “The Goldman Sachs deal is a very sexy story between two sinners,” addressing both Greek government and the abovementioned bank. (Dunbar and Martinuzzi, 2012) Goldman Sachs made a great deal – by 2005, the price of the transaction – the money Greece now owes to GS – drastically rose, being 5.1 billion euro, which brought a lot of revenue to the bank and further worsened the position of Greece on international market.(REPEATING CITATION)

1.4 Shadowed truth

The deal with Goldman Sachs, however, was not the only mistake of Greek government. The thing is, after Election of George Papandreou, leader of Pasok socialist patry, in 2005, it is revealed that starting from 1999, Greek government has been carefully cooking the books and faking the improvement of Greek economy to Eurostat, and this revelation caused many EU concerns and public resentment. According to the new data, the reported budget deficit of 6% was more than double in reality, and debt-to-equity ratio was really depressing as well. (BBC News, 2004)

1.5 “Dream games” and Financial Crisis of 2008

Joining European Monetary Union (finally), Greece got a whole lot of possibilities: comfortable, tax-free trade, support of many european countries –

all of this positively contributed to financing the government, helping to ease the economic struggle. There still was a trial, however, – Greece was in charge of hosting the 2004 summer Olympic Games, and in the end, it appeared to be 9 billion euros - double the original budget and almost five times more than the Sydney 2002 expenditures. (BBC News, 2004) Luckily, the economy of Greece is gradually growing, which helps it to cope with the heavy spendings, but in four years begins its story the US housing crisis, which led to one of the greatest recessions - 2008 financial crisis. Of course, there is another trace leading to Goldman Sachs and its actions, but that is a whole different story. The most important thing is that the crisis influenced every single state, having them clinging to international aid and trying to pull themselves together. This had Greece to return to its hardest times.

SECTION 2 : Official Support for Greece

2.1 Introduction to IMF and the 'Troika'

International Monetary Fund (IMF) is an organisation created to achieve growth and prosperity to its member-states, their number being currently 190. It also has powers to provide relevant economic advice and overview of the current policies when needed, seeking to improve financial stability and maximum effectiveness of monetary cooperation, which in order boost productivity, creation of new workplaces and generally improve economic wellbeing. (IMF, 2024) Feeling a strong need in drastic measures towards Greece's economy as a whole, the three international institutions – IMF, European Central Bank (ECB) and European Comission – decided to form a close alliance, which will share their duties while closely monitoring Greece, and this alliance was publicly adressed to as "Troika", the name apparently being originated from Russian and meaning a carriage with three horses, or generally a collaboration of three entities.

2.2 Three bailout packages

In 2010, the Troika decided on provining Greece with a 3-year economic adjustment programme, often referred to as the Greek Loan Facility or first bailout package, financial assistance in a form of bilateral loand from other EU countries. Greece managed to receive 52.9 billion euro, with additional 20.1 billion provided by the IMF. Just reaching the third year of the programme, it was replaced by Second economic adjustment package, being a collaboration between Troika and newly astablished European Financial Stability Facility (EFSF), due to the need of reevaluating Greece's ratios and amount of debt.

The second package brought to Greece €141.8 billion, with €12 billion proided by IMF. (European Council, 2019) Within this package, the state finally showed some positive movements in GDP, once again being able to issue government bonds. The trird and final programme featured ESM and recapitalisation of national banks, to help Greece rehabilitate from inside. The total disbursement consisted of €71.9 billion divided into 5 tranches, €5.4 billion of which were paid at the end of 2015 to recapitalise Piraeus and NBG banks.(ESM, 2024) . This was the end of bailout packages, as crisis was eliminated and Greece was now able to self-recover with all domestic activity back on track.

2.3 Public concerns

As pleasant as the possibility of continious funding was, it brought a lot of public resentment. You see, there was quite a catch in all the generous bailouts from EU: as Greece was already in severe debt, the IMF required Greece to undertake severe austerity measures to speed up the recovery process, and that only meant absolutely awful conditions for working class. Featuring tax rises and cuts in wages, pensions and public service pay, the people of Greece rioted, but the finance minister George Papandreou stated that not going bankrupt is an unshakable proirity, and it is a pity that “it is not going to be easy on Greek citizens, despite the efforts that have been made and will continue to be made to protect the weakest in society”. According to BBC news, the following changes, implemented to cut Greece’s public deficit to 3%, were the most dramatic of ever made:

- cancellation of any bonus payments for public service workers
- limits on bonus payments and their abolition for high earners

- locking wages and pensions for the next 3 years
- Increase of VAT from 21% to 23%
- raised excise tax by 10%
- taxation of illegal constructions

(BBc News, 2010)

and this is not a complete list of cuts that citizens of Greece had to go through. Even changes in the political field did not bring any social benefits, as the new leader Antonis Samaras from New Democracy, elected in 2012, continues to support and revise new adjustment programmes, which will be executed in following years. On 16 July 2013, there will take place a largest strike of EU-Greece, where about 18 thousand citizens will march to the Athens. (Bensasson and Chrepa, 2013)

SECTION 3 : European Stability Mechanism

3.1 In the need

In 2010, an intra-European crisis emerged from the US housing collapse, locking in negative consequences: an international distrust takes place, with many eurozone states starting to demand sky-high interest rates from borrowing countries, which approach default for being unable tp repay their debts. This was the impetus for creating an advanced body, that will take care of the default countries and maintain their long-term financial stability and prosperity.

3.2 EFSF, ESM, and their functions

With these thoughts in mind, a European Financial Stability Facility (EFSF) was created in 2010, being a temporary solution for the abovementioned ploblem; and after 2 years, the European Stability Mechanism is finally introduced as the leading financial support in the EMU. Its responsibilities range from quite a big area of functions, as European Stability Mechanism is now responsible for flawless support for countries that are near to or experiencing severe financial distress. Its main tasks being identificaating of the root problem of a state and eliminating it as soon as possible, there are lots of supporting mechanics equipped, including careful assessing the economic state of a country, issuing lends and reforms tailored to its needs, and acting as a policy-making entity, coordinating crisis management strategies in case of a recession. (ESM Treaty, 2012)

SECTION 4 : IMF in the Crisis: A Critical Assessment

4.1 Role of the IMF: Overview

The IMF's role in the Greek debt crisis was to ensure the country's fulfillment of its financial obligations – however, the actions of this organisation are more than doubtful. Despite meeting its objectives of eliminating Greek debt, bringing austerity as necessary part of the deal shook social and economic areas of Greece. These measures brought to distress in labour market, raising unenployment and poverty. No wonder that the IMF's measures are widely criticised, and addressed as the reason of such prolonged timeframe of Greek crisis. (Nelson, 2020)

4.2 Possible solutions and tactics

Certainly, the IMF could allow more flexibility in its austerity measures, instead of completely drowning social benefits - severe cuts in the public sector were one of the reasons of Greek economy continuing its recession cycle. In fact, there could be more deep reassessment of the economic and financial policies in Greece to come up with more efficient plan on revlieving the debt burden or restructuring it , so that the country can gradua;ly repay its loans without putting too much pressure on its reserves. A last, but not least, there should have been more attention paid to the government manipulations, as corruption and official statistics falsification were things that brought Greece to problems in the firt place, but were not addressed enough between all the other problems – maybe, this was the biggest flaw in the IMF's tactics, as it was mostly addressing consequences, not the primary causes of the Greek debt crisis.

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